No. [illegible]

APR 15 1

In The

# Supreme Court of the United States

October Term, 1946

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St. Louis-San Francisco Railway Company (Debtor), [illegible], as administrators of the Estate of P. G. Kessler, Deceased, [illegible], Administrator of the Estate of Robert E. Lee, Deceased; [illegible], Administrator of the Estate of Leonard E. Lee, Deceased, and [illegible], Administrator of the Estate of Elmer G. Lee, Deceased, Petitioners,

vs.

Fort Scott Reorganization Committee; Bankers Trust Company, Trustee for the Kansas City, Fort Scott & Memphis R. Co.; Frank Lyon Reorganization Committee, Central Hanover Bank & Trust Company, and David K. Catlin, Trustees for St. Louis-San Francisco R. Co. Prior Lien Mortgage; Consolidated Reorganization Committee, Chase National Bank of the City of New York and John A. Ash, Trustees for St. Louis-San Francisco R. Co. Consolidated Mortgage and Frank A. Tichenor, Trustee, St. Louis-San Francisco Railway Company, Respondents.

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PETITION FOR WRITS OF CERTIORARI AND [illegible] TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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WILLIAM M. KINSEY,
[illegible],
Attorney for Petitioners.

[illegible],
[illegible],
Attorneys for Petitioners.

[illegible],
[illegible],
Attorneys for Petitioners.

[illegible],
[illegible],
Attorneys for [illegible] and John A. Ash, Appellees.

15750

**TITLES OF CASES IN WHICH THIS PETITION IS FILED**

LOLA BROOKS, Administratrix of the estate of F. S. Brooks, deceased, *Petitioner,*

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, Debtor, et al., *Respondents.*

(No. 13105 in the Circuit Court of Appeals)

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JOHN E. DIKIS, as Administrator of the Estate of Robert E. Lee, deceased, et al., *Petitioners,*

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, Debtor, et al., *Respondents.*

(No. 13106 in the Circuit Court of Appeals)

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ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, Debtor, *Petitioner,*

vs.

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, and JOHN A. AID, Trustees under the Consolidated Mortgage of St. Louis-San Francisco Railway Company, et al., *Respondents.*

(No. 13107 in the Circuit Court of Appeals)

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The following appeals have been taken from Orders entered in the reorganization proceedings in this cause:

Reconstruction Finance Corporation and the Railroad Credit Corporation appealed from an Order of the District Court returning the first certified Plan to the Commission for further consideration. These appeals were entitled:

RECONSTRUCTION FINANCE CORPORATION, *Appellant*,

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, Debtor, et al., *Appelles*,

(No. 12471 in the Circuit Court of Appeals)

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and

THE RAILROAD CREDIT CORPORATION, *Appellant*,

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, Debtor, et al., *Appellees*.

(No. 12472 in the Circuit Court of Appeals)

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The issues were compromised November 23, 1943 and the appeals dismissed. The record on those appeals was printed and the printing has been by order of the Court of Appeals used as a printing of part of the record in these cases and is referred to in briefs as R. vol. , page .

The three appeals numbered 13105-6-7 in the Circuit Court of Appeals were consolidated for hearing on a record brought to date and by order of the Court of Appeals appellants and appellees printed appendices to their briefs incorporating parts of the record.

The Debtor appealed to the Circuit Court of Appeals from an Order of the District Court lifting the injunction against sale of collateral by the creditors and permitting bank creditors to sell the Debtor's own bonds held as collateral for indebtedness evidenced by notes. That Order was appealed to the Circuit Court of Appeals and the title is

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, Debtor, et al., *Appellant,*

vs.

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK and JOHN A. AID, Trustees under the Consolidated Mortgage of St. Louis-San Francisco Railway Company, et al., *Appellees.*

(No. 13108 in the Circuit Court of Appeals)

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The Circuit Court of Appeals declined to consolidated this appeal with the preceding numbers. The Order of the District Court was affirmed. The procedure followed by the Court of Appeals makes necessary a separate petition for certiorari in this cause.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1945

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No. ..... Original

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ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY et al.,
*Petitioners,*

vs.

FORT SCOTT BONDHOLDERS' COMMITTEE, et al., *Respondents.*

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**PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.**

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The Debtor, St. Louis-San Francisco Railway Company, on behalf of all interests it is privileged to represent by the terms of Section 77 of the Bankruptcy Act, and Lola Brooks, Administratrix, and John E. Dikis, Administrator, respectively representing creditors of the Debtor holding judgments for personal injuries for $4,000 and $17,500 respectively,* pray for writs of certiorari to review an Order of the Circuit Court of Appeals of the Eighth Circuit entered on the 8th day of February, 1946, approving a Plan of Reorganization of Debtor's financial structure which was proposed by the Interstate Commerce Commission and certified to the District Court for the Eastern District of Missouri on the 4th day of July, 1944 and October 2, 1944.

* The total of unsecured claims has not been adjudicated but the estimated amount is $400,000.00.

The Plan denies to the Debtor and its stockholders any participation, present or contingent, in the reorganized company, and likewise gives no recognition to any creditor except bondholders whose claims are secured by mortgage or by the deposit of Debtor's own bonds as collateral. (Appellees Appendix Page 867).

The questions submitted by petitioners are of general concern to all having an interest in railroad reorganizations under Sections 73 and 77 of the Bankruptcy Act.* They involve—

(1) Vital questions of appellate procedure under the Act upon which there is confusion evidenced by diversity of views between the Circuit Court of Appeals of the Eighth Circuit and the Circuit Court of Appeals of the Tenth Circuit;

(2) A diversity of view and decision as to the right of the Debtor to represent the rights of unsecured creditors not otherwise specially represented and urge the protection of such rights in any Plan, as evidenced by the diversity of view between the Circuit Court of Appeals of the Eighth Circuit, which does not recognize such right, and the Circuit Court of Appeals of the Seventh Circuit, which does recognize it, the position of the Circuit Court of Appeals of the Seventh Circuit being supported by the views of at least one Federal District Court, to-wit, Judge Hincks of Connecticut, and,

(3) A mistaken application of the decisions of this Court in the four leading reorganization decisions,† which has resulted in preventing the District Court in this case (and other courts in other similar cases)

(a) from performing their judicial function as courts of bankruptcy and equity to recognize applicable

* Section 73 is Title 11, Section 201 of U.S.C.A., and Section 77 is Title 11, Section 205 of U.S.C.A.

† *Case v. Los Angeles Lumber etc.*, 308 U. S. 106; *Consolidated Rock Products etc. v. DuBois*, 312 U. S. 510; *Ecker v. Western Pacific etc.*, 318 U. S. 448; *Group etc. v. C. M. & St. Paul etc.*, 318 U. S. 523.

rules of administration of assets in *custodia legis* so as to relieve the debtor of a substantial part of the burden of its debts made possible by favorable operating results and cash accumulations, and furthermore to recognize the rights of unsecured creditors to an interest in the debtor's property undiminished by the accumulation of interest during administration in favor of mortgage creditors;

(b) from exercising the specific and additional powers given to the courts by Section 77 by which the court through its trustees, if so disposed, could use the assets in its hand and by negotiation and agreement with individual creditors reduce the burden of principal debt and interest accumulating at high rates during administration;

(c) from making a thorough judicial search to determine on what basis of fact any creditor or stockholder is to be justifiably excluded from further recognition and whether there is evidence on the record to support such action.

Petitioners ask permission to submit to the Court the question whether this Court in the Ecker and Milwaukee cases, in which *approval orders* were involved, assumed that by proceedings taken in the district court subsequently thereto steps would be taken, by foreclosure in accordance with debtors' covenants or otherwise pursuant to lawful consent of the debtor in composition, to forfeit the equity of debtors, and whether it intended to hold that the interest of a debtor or any creditor's interest could be lawfully expropriated by fiat.

## OPINIONS BELOW

The Opinion of the Circuit Court of Appeals is certified in the record and printed as Appendix C to this petition.

The Opinion of the District Court approving the Plan is reported in 59 Fed. Sup. 417.

**The Finance Reports of the Interstate Commerce Commission (printed in the Submission Pamphlet) are reported in 240 ICC 383, 242 ICC 523, 257 ICC 399, 717.**

**JURISDICTION**

**The Order of the Circuit Court of Appeals was entered on the 8th day of February, 1946.* The jurisdiction of this Court in invoked under Section 240a of the Judicial Code, as amended by the Act of February 13, 1925 (28 USC, §347).**

**QUESTIONS PRESENTED**

**1. Was it proper practice for the Court of Appeals to consider and rule upon an appeal from an Order of the District Court approving a Plan of Reorganization while there was duly pending in the same Court of Appeals an appeal from the Order of the District Court confirming the Plan, which latter appeals stands undisposed of without hearing on the merits?**

**2. Does Section 77 give the Debtor right and authority to represent the claims of unsecured creditors to whom the Plan makes no allowance of new securities?**

**3. Have the Federal District Courts and Courts of Appeal mistakenly misinterpreted the decisions of this Court so as to prevent them from carrying out measures incident to the administration of the assets and affairs of the Debtor which, under bankruptcy rules and consistent equity rules, they have the duty and jurisdiction to perform in their judicial character as courts having property and rights in *custodia legis* and so as to prevent them from performing additional judicial administrative duties relative to the application of income and the adjustment of debts, the power and authority for which is granted by Section 77, to-wit:**

> **(a) If the stated capitalization of Debtor's assets represents a worth or value in terms comparable with Debtor's debts, and that worth is in excess of the**

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* Appendix C.

principal as of May 16, 1933 of the claims of all creditors now having claims against the Debtor (after uncapitalized cash available is used to reduce the principal of those debts) bankruptcy does not permit the accrual of interest during administration in favor of one creditor to the prejudice of another if, as here, the creditors are looking for payment to a distribution of a common fund. (This does not apply to a creditor who takes his security out of the fund and either waives all rights in other assets or seeks to prove with other creditors against the common fund for deficiency.)

Has this Court held that this rule is not to be applied in the administration of Debtor's assets?

We submit that the Court of Appeals acted upon the assumption that it has, and that, in consequence, the rights of unsecured creditors were erroneously denied.

(b) The Trustee of the District Court has in hand an excess of $1,000,000 unmortgaged cash.

Do the decisions of this Court require the application of this cash to the claims of mortgage creditors who have not established a deficiency claim by foreclosure of their security?

The Court of Appeals has made it clear that the unsecured creditors must in some way so share these unmortgaged assets with the mortgage creditors that the share of the unsecured creditors,* would be inconsequential. If this is true, it means that the court can estimate a deficiency claim not established by foreclosure. We believe that this result was reached in mistaken understanding of the decisions of this Court and that this Court did not intend to say that the ordinary rules for allocating a debtor's property among its creditors by a court of bankruptcy were superseded by Section 77.

(c) By the rules of bankruptcy administration and consistent equitable principles, and having in mind

* Erroneously assumed to be $21,000.

the mandate of Section 73, the bankruptcy court should make all possible payments on the principal claims whenever assets in its hands are available for distribution and it is not concerned with interest accumulated during administration until on *liquidation* (not contemplated by Sec. 77) it is proved that debtor's assets exceed the principal of all creditors' claims. All impounded earnings are added to the mortgage security and they are distributable on principal of the secured claims and in equity reduce the accumulation of interest. If retained by the court they are borrowed and interest thereon should be allowed to creditors not at the contract rate but at a lower rate at which the court can obtain the money elsewhere.

The District Court and the Court of Appeals have refused to so apply and allocate accumulated earnings in excess of $135,000,000. Such a refusal can be predicated only on the assumption that this Court has held that after the Debtor's assets come into the hands of the court they *must* be distributed according to a plan which makes whole all creditors for principal and interest during administration without the benefit of customary bankruptcy accounting during the period of administration.

We believe this Court has not so held.

(d) It appears that Section 77 gives to the bankruptcy court new powers superimposed on the ordinary powers of the court, which new powers are substantially equivalent to the powers of a board of directors of debtor's corporation to use its assets and earnings for the betterment and strengthening of its financial structure. By the exercise of these powers, plus the inherent powers which a court of equity enjoys to use the assets in its hands to insure the doing of all things required in the public interest, the debt burden of the Debtor could have been during the administration—and yet can be—reduced by refunding bonds at reduced interest rates, purchasing bonds in

the open market with all interest accumulations at less than par, and in various and sundry other negotiated ways.

The interpretations put upon the decisions of this Court above referred to by the lower Federal courts prevent the exercise of such powers by the District Court because if a Plan of Reorganization *must* provide for the satisfaction of the principal of all creditors' claims plus all interest accumulated at contract rates during administration, it is inconsistent to use Debtor's assets for the purpose of discounting admitted claims.

We submit that no such result was intended by this Court in any of its decisions.

(e) It is assumed by the District Court in this case, and affirmed by the Circuit Court of Appeals, that if the Interstate Commerce Commission hears *all possible evidence* its conclusions are beyond correction by the courts. This position follows from the view that this Court has declared the law to be that a Plan may be based on an estimate of future earnings and that the Commission's estimate thereof is conclusive.

We submit that this Court has not relieved the District Court and the Circuit Court of Appeals of the duty to examine the evidence and determine whether *all the evidence* does or does not furnish a factual basis for the estimate of future earnings.

4. The District Court and the Court of Appeals assume that the language of the Court used in the consideration of the *approval* Orders which were before this Court in the *Ecker* and *Milwaukee* cases is a controlling decision that compels them to hold that when an order of *confirmation* is entered such *final order*, which is *dispositive* of Debtor's interests by fiat based on estimates, cannot be challenged under the Fifth Amendment to the Constitution. There is grave doubt whether such is the effect of the language of this Court used in the *Ecker* and *Milwaukee*

cases and parties whose large interests have been expropriated are not content to submit uncomplainingly until the constitutionality of such a *dispositive* order is definitely settled by this Court.

## STATUTES INVOLVED

Sections 73 and 77 of the Bankruptcy Act (now Title 11 section 201 and Title 11, section 205 USCA) are the statutes involved and the pertinent parts thereof are printed in Appendix A.

## STATEMENT

On November 1, 1932 a bill on behalf of all creditors of the Debtor was filed by Hobbs Western Company, plaintiff, alleging, inter alia,

> "although the property and assets of the Railway Company at their fair value are greatly in excess of the Railway Company's liabilities yet at the present time the Railway Company is unable to pay its obligations as they mature in the regular course of business or otherwise to provide for them."*

and asking for the appointment of a receiver. On said date a receiver was appointed to take possession of Debtor's assets, including in excess of one million dollars of unmortgaged cash.

On May 16, 1933, Debtor filed a petition for corporate reorganization in the district Court of the United States for the Eastern District of Missouri, Eastern Division, submitting therewith a reorganization plan bearing the final date of April 10, 1933, providing for a comprehensive readjustment of Debtor's obligations, including authorization to purchase and retire certain items of debt at substantially less than the face thereof (R vol. 1, p. 66).

Hearings began before the Interstate Commerce Commission on the proposed Plan, which had been agreed to by the corporation and more than 66% of each class of all

* Vol. 1, Receivership Proceedings, page 25.

mortgage creditors. On the 17th day of March A. D. 1937 the proposed Plan was rejected by the Commission.*

Hearings on a modified Plan were resumed before the Commission on the 8th day of February A. D. 1939.

On the 6th day of July, A. D. 1940 (Supplemental Report November 16, 1940) the Interstate Commerce Commission proposed its own Plan. This plan was certified to the District Court, objections were filed by the mortgage creditors to the treatment of the Reconstruction Finance Corporation and the Railroad Credit Corporation, and by the Consolidated Bondholders' Committee to their treatment as compared to other creditors, and by the Debtor.

The Plan was rejected by the District Court and returned to the Commission.

The Reconstruction Finance Corporation and the Railroad Credit Corporation appealed to the Circuit Court of Appeals of the Eighth Circuit from the Order of the District Court sending the Plan back to the Commission. This appeal was taken on or about February 4, 1943. Pending the appeal no progress was made in further hearings before the Interstate Commerce Commission.

On or about the 23rd day of November, 1943 the Reconstruction Finance Corporation and the Railroad Credit Corporation by agreement with the mortgage creditors compromised their claim and for a payment of $5,800,000 the claims were released.

On the 16th day of February A. D. 1944, hearings were resumed before the Interstate Commerce Commission and the mortgage creditors proposed a new Plan. On July 4, 1944 the Interstate Commerce Commission reported a new Plan which conformed substantially to the creditors' Plan. (The Commission's Supplemental Report was dated October 2, 1944.)

On March 16, 1945 the District Court having heard the objections of the Debtor and Brooks Admx., and Dikis

* 221 I. C. C. (Finance) 199.

Adm'n., entered an order approving the Commission's Plan.

The Debtor and Brooks and Dikis appealed from the Order of Approval to the Circuit Court of Appeals of the Eighth Circuit. These appeals are described on the first page of this petition. They were consolidated in the Circuit Court of Appeals for hearing and disposed of by the Order of the Circuit Court of Appeals dated the 8th day of February, 1946.*

Following the appeal to the Circuit Court of Appeals from the Order of Approval the Commission submitted the Plan to mortgage creditors for acceptance or rejection by vote, and the Plan received from them an enthusiastic majority.

Thereafter, and on the 15th day of November, 1945, the District Court entered a confirmation order.

The Debtor and Brooks and Dikis promptly appealed from the Order of Confirmation, a motion was made before the Circuit Court of Appeals to have the record as made and printed in Nos. 13105-6-7 (the cases here involved) made available as part of the record on the appeal from the Order of Confirmation. The creditors moved the Circuit Court of Appeals to dismiss the appeal from the Order of Confirmation without hearing on the merits. At this writing these motions remain undisposed of.†

During administration approximately $38,000,000 has

* There is a group of bank creditors holding notes aggregating in excess of $5,106,000 as collateral for which bonds of the Debtor of the face value of more than $8,000,000 are held. During the reorganization proceedings the sale of this collateral has been stayed, but on the 17th day of April, 1945, the District Court lifted the stay. An appeal from that action was taken to the Circuit Court of Appeals and in that case the Cause is No. 13108, St. Louis-San Francisco Railway Company, Debtor, appellant, v. The Chase National Bank of the City of New York and John A. Aid, Trustees under the Consolidated Mortgage of St. Louis-San Francisco Railway Company, et al., appellees. That cause was not consolidated in the Circuit Court of Appeals and Debtor is compelled to file a separate petition for a writ of certiorari to review the Order of the Circuit Court of Appeals in that cause which was entered concurrently with the orders in Nos. 13105-6-7.

† Petition for Rehearing, C. C. A. Page 1.

been applied to pay claims as they existed *(principal and interest)* on May 16, 1933, as follows:

| | |
|---|---|
| Equipment Trust Claim—principal | $18,712,000.00 |
| interest | 436,772.50 |
| Birmingham Bonds | 6,517,170.00 |
| Kansas City & Fort Scotts—principal | 791,067.00 |
| interest | 516,700.00 |
| Prior Lien Bonds—interest | 2,476,779.00 |
| Consolidated Bonds (4½s and 6s)—interest | 2,736,862.00 |
| Reconstruction Finance Corporation $5,190,000 claim settled for | 4,504,575.00 |
| Railroad Credit Corporation $3,805,175 claim settled for | 1,300,000.00 |
| | $37,991,926.20 |

The original claims as of May 16, 1933 include the principal of debt plus accrued and unpaid interest to that date. Of such original claims roundly $268,200,000 remain unpaid. (Interest on these claims during administration is not included in this figure.) There is today well over $35,000,000 of cash available for the payment of principal of these claims, leaving $233,000,000 of principal to be satisfied by Debtor's assets. If the cash in hand could be used to buy up Debtor's securities at market the burden of the principal of its debt would be drastically reduced. Over and above the last stated amount is the unsecured debt estimated at $400,000.

In the Courts assets there is more than $1,000,000 unmortgaged cash earned before November 12, 1932, which is the date when a receiver was appointed. The fund is of vital importance to the unsecured creditors.

If, as Debtor contends, the distribution of $63,000,000 to the secured creditors is applicable to principal, the principal of these claims is further reduced, and if the entire distributable earnings approximating $135,000,000 are, as Debtor contends, chargeable to principal, the reduction will be greater, but the last mentioned reduction will be offset by the court's obligation to the secured creditors

for a part of the earnings on their security borrowed by it. Some of these earnings were attributable to the Kansas City & Birmingham division and some to Equipment Trusts. A careful accounting is necessary to determine what credits and charges should be made.

In the above computations we have purposely omitted the inclusion of approximately $100,000,000 of an interest claim representing what is claimed to be an amount legally accumulated *pendente lite* according to the terms of the mortgage indentures. We believe that Debtor is entitled to have this claim given equitable scrutiny under all the facts and circumstances; that the Commission has no official competency to fix the claims involved and that the court has failed to give any attention to them because of its misinterpretation of the decisions of this Court. If this demand for interest *pendente lite* is equitably appraised, even the Commission's notion as to the worth of Debtor's assets would demonstrate an equity in the Debtor. A re-examination of that worth in the light of conditions now known would greatly increase that equity.

In the view of the Commission and Court there remains of the original claims $269,711,460 in principal amount. In the opinion of the Debtor a substantial part of this indebtedness could have been minimized by the equitable application and the prudent use of the earnings which the court has realized from the operation of Debtor's property.

The maturing of a Plan of Reorganization has been delayed in most part by controversies between the creditors. The Commission and Court take the view that the interest *must* be allowed to accrue at contract rates during administration and that the unpaid interest remaining after the distribution of approximately $63,000,000 due to the mortgage creditors other than those whose obligations have been wholly retired has left an accumulated burden of interest *pendente lite* amounting to approximately *$100,000,000.* Debtor challenges the allowance of so great an interest charge and claims that by the use of the powers

given to the court by Sections 73 and 77 its debt burden could have been greatly reduced, and complains that because of the mistaken belief that this Court has ruled to the contrary, no substantial effort in that direction was made. The aggregate indebtedness principal and interest adopted by the court and the Commission is, therefore, $366,000,000 roundly, as of January 1, 1944.

On May 16, 1933 the book value of the Debtor's stockholders' interest (15,000 to 16,000 of them) was approximately $80,000,000. Notwithstanding the assumed accumulation of interest the book value of the stock is now more than $35,000,000.*

From the time the Debtor was released from Federal control until the collapse of the industries served by it in 1930 the property earned an average of $9,100,000 per annum over contract charges (1920-30). During the Depression it failed to meet those charges by an average of $8,900,000 per annum (1931-40). Since the revival of industry in the territory served by it, it has earned for the years 1941-45 inclusive an average, roundly, of $7,800,000 per annum over and above fixed charges (after deducting all income and excess profits taxes). This earning figure is arrived at after the deduction of large wartime amortization in the years 1944 and 1945.

The "earning power" which is demonstrated before the deduction of income and excess profits taxes for 1941-1945 inclusive averages $15,000,000 per annum over contract interest charges.†

The trustees have earned net operating income (to end of 1945) approximating $135,000,000,‡ and have had

* As of Dec. 31, 1944. It is more at this time.

† The report of the Interstate Commerce Commission to Congress of 1944, at pages 7-8, says:

"The net income before deduction of income and profits taxes deserves attention as indicating the earning power of a railroad with the existing rates, fares, expenses and traffic volume." See Committee Report No. 925, Senate, Appendix B, page 62.

‡ Annual Report of 1944.

the advantage of approximately $49,000,000* in depreciation deductions. This has made available to them in cash approximately $184,000,000 to be used for the benefit of Debtor and its property.

The accrual of interest at contract rates during the period of administration to the end of 1945 was approximately $164,000,000.

The compromise of the claims of Reconstruction Finance Corporation and Railroad Credit Corporation resulted in a diminution of principal debt by $8,995,000, which was more than the cash payment made, and stopped the running of interest on those claims. The payments for low interest bearing Equipment Trusts, approximately $18,712,000 principal, and for the retirement of the Birmingham bonds, approximately $6,517,170, were of much less benefit to Debtor's estate than would appear to have been possible of attainment if the same amount of cash had been used to acquire bonds of other issues at market, thereby reducing debt and tolling interest in far greater amounts than the cash payments which were actually made.

$63,000,000 in cash was used to pay interest on bonds, most of it on interest which accrued during administration at contract rates, which for some years have been far above the current money market. When these payments were made the court reserved the right to reallocate, but has refused to reallocate.

Many of the bonds on which interest was so paid could have been purchased in the market at the time of such payments at much less than par and the bond and all accrued interest retired.

Approximately $72,000,000 of earnings plus $49,000,000 depreciation reserve was withheld by the court and used for additions and betterments and other purposes (including the retirement of debt above mentioned). Instead of treating this amount above depreciation reserve as a borrowing and paying interest at rates at which money was ob-

* Total is shown by adding Trustee's reports of depreciation for '33-'44.

tainable elsewhere in the market, it was not so accounted. Interest was allowed to accrue at the old contract rates on the old debts and the opportunity to relieve the Debtor of the accumulating burden in large part was not taken advantage of. Debtor has persistently and consistently objected to the accumulation of such interest.

Over $37,000,000 in income and excess profits taxes have been paid to the taxing authorities by the trustees, although the creditors impounded the earnings and they had the right to demand them for addition to their security and distribution to themselves.

Because of these policies of court administration the apparent spread between the large debts as figured by the Commission and the court, and the low dollar figure assigned to the new securities and shares by the Commission is greatly increased.

The Commission assigned a stated value of $50 per share to the new stock which it authorized. This results in an assumed capitalization of $247,000,000. Even this figure exceeds the principal of all remaining secured creditors' claims and is ample to provide for the recognition of Brooks and Dikis as judgment creditors, and all other unsecured creditors.*

In the first Plan certified by the Commission (July 6, 1940, November 16, 1940) the Debtor's assets brought by it into court were assumed to justify a "capitalization" of $240,000,000. Since that time there bave been invested in additions and betterments by the trustees over $30,000,000 cash. In the latest capitalization of $247,000,000 (Commission report of July 4, 1944) not to exceed $7,000,000 added capital is possible to be attributable to this added investment.

* The mortgage creditors claim that the Birmingham bonds and the RFC and RCC claims were acquired by the use of funds belonging to the mortgage creditors and that they are subrogated to those claims. It is not easy to detect the effect of this subrogation as increasing the amounts of their claims. This claim seems to support the Debtor's contention that the earnings belonged to the creditors and should be charged to them and treated as borrowed by the court.

There has been abandonment of 900 miles of road that has served its usefulness to the betterment of net income of approximately one million dollars per annum. At the Commission's rate of capitalization (5%) this would account for $13,000,000 additional capital over and above the $7,000,000 which was in fact added. There have been new permanent (not war) industries located on the line of the road which are yielding $5,000,000 per annum new net income. No increase of capitalization can be detected because of this factor. By applying the Commission's method of computation it would justy $100,000,000 of added capitalization.

There is now more than $30,000,000 cash in the hands of the trustee not capitalized,* but certainly available for the payment of obligations at par and, we believe, available for the purchase of securities at market.

Therefore, we believe that with a proper accounting of the true indebtedness and a just appraisement of the new securities as a currency for exchange for the debts the spread between debts and assets will not only be closed but unsecured creditors will be recognized and an important equity for the Debtor will be established.

There is not the slightest question about the physical excellence of Debtor's railroad, the need for it in the National Transportation System, the economy with which it can operate or the present public demand for its service.

### REASONS FOR GRANTING WRIT

**Question 1.**

Section 77 provides for an Order of Confirmation "subject to the right of judicial review" (§77-f). This is the order which *disposes* of Debtor's assets by the allocation of securities based on them. If none are allotted either

* In the Commission's Report of October 2, 1944, the Commission answered Debtor's objection that substantial assets were not capitalized by referring to the case of *Louisville & Nashville*, 76 I. C. C. 718 (see page 343 of appellees' appendix). This case holds that cash above working capital is not capitalizable. It certainly is the best possible asset for use in reducing debts.

to an unsecured creditor or the debtor there is a total expropriation of such interests. The distribution of securities is made in accordance with the confirmation order (§77-f). A confirmation order is referred to in the statute (§77-j) as the "final decree".

All appellate practice is grounded on the rule that an aggrieved party may have his rights considered at a full and free hearing on review by an appellate court directed to the *final decree.* The right of a litigant to such a plenary review on final decree ought not be left obscure.

Section 77 injects an order of approval into the sequence of procedure. It is obvious that until final decree it cannot be known whether the proposals in the *approval* order will be incorporated in the order of confirmation. There are votes to be taken (§77-e). Changed conditions may justify dismissal (§77-g). A dismissal order may be conditioned on a change of the Plan.

Faced with the threats inherent in an *approval* order a denuded debtor has no clear road to relief. If he stands by and lets the proceeding go on without taking every step in protest open to him he may lose his rights. If, as here, he *appeals* from the *approval* order and it is affirmed, he is faced with the same problem in connection with an application for review by this Court. It is obviously a confusing problem to one who should have a full hearing and decision on any *final order* which expropriates his property.

In a case where no order of confirmation has been entered it might be profitable to inquire whether on an appeal to the Circuit Court of Appeals there is more for it to do than to advise the bankruptcy court that there are features of the approval order which, if carried out, will not be lawful even if by subsequent steps the bankruptcy court should in a lawful way forfeit the excluded interests.

There seems to be a question whether the Court of Appeals should not say that the lawfulness of a debtor's exclusion will not be decided until on a consideration of the

final decree the Court of Appeals can know what steps have been taken to forfeit the debtor's interest.

But these problems would seem to disappear when, as here, the Court of Appeals has before it the final order of confirmation. By hearing on such order of *confirmation* the whole matter can be examined and disposed of. It would seem that so long as the appeal from the *order of confirmation* is undisposed of no approval order or other intermediate or interlocutory order made in the progress of the proceedings should be ruled upon.

The Eighth Circuit in this case has ruled on the appeal from the Order of Approval while the appeal from the Order of *Confirmation* is pending before it.

In the case of *Denver and Rio Grande Western v. Insurance Group et cetera,* (150 Fed. 2d, 28), (a case which at this writing stands on certiorari in the Supreme Court), the Tenth Circuit Court of Appeals had before it an appeal from the *approval* order taken by the Debtor. At the argument of that appeal it was informed that the District Court was about to *confirm* the Plan and that an appeal from that Order would be taken. It stayed its proceedings until the appeal from the Order of *Confirmation* taken by the General Mortgage and the Debtor was lodged, then gave a prompt hearing and disposed of the case.

This Tenth Circuit procedure recognized the *merger* of the two judgments and followed the analogy of the cases in this Court wherein appeals from orders on application for interlocutory injunctions and appeals from final orders in the same suits were concurrently pending here,* and it was held that the proper course was to dispose of the matter in the final orders.

The Circuit Court of Appeals of the Eighth Circuit was advised on the 14th day of January, 1946, that an Order confirming the Plan would shortly be brought before it. (See paragraph *8th* of Order of June 25, 1945.)

* *Shafer v. Carter*, 252 U. S. 37; *Pacific Tel. Co. v. Kuykendall*, 265 U. S. 196; *Smith v. Illinois Bell Telephone Co.*, 270 U. S. 589.

It was so advised at oral argument on appeal from the Order of Approval had at St. Louis on the 12th day of November, A. D. 1945. It was so advised by a brief filed with it in this cause on the 17th day of November, A. D. 1945. On the 14th day of December, 1945, Debtors' appeal from the order of *confirmation* was lodged in that court.

Notwithstanding these transactions the Court of Appeals treated the question as though no appeal from *confirmation* were lodged with it. It used the following language:

> "* * * it is suggested that the decision of this case be held until it is determined whether there will be an order of confirmation brought to this court on appeal and that such an appeal should be considered before we decide the issues on the present appeal."

There is a major conflict on an important point of appellate practice in which the two Circuits are diametrically opposed. The Eighth Circuit did not follow the clear analogy in the cited decisions of this court.

The *approval* order is not dispositive. Problems arising from the Fifth Amendment to the Constitution cannot be solidly raised upon its review. It is not the threat of the *approval* order but the mandate of the order of *confirmation* which delivers the hurtful blow. When that blow falls the right to appeal to the protection of the Constitution accrues.* The whole case is not matured until the final decree—a dispositive order—is entered.

**Question 2.**

The rights of judgment creditors and unsecured creditors are treated by the Circuit Court of Appeals as confined to the claims of Brooks and Dikis aggregating $21,500 principal, but there are other such claims estimated to total $400,000. These are treated as unrepresented. The Debtor's claim of right to represent them is ignored.

In the matter of the New Haven reorganization, Dis-

* *Gange Lbr. Co. v. Rowley*, 90 Sup. Ct. Law Ed. 80.

trict Judge Hincks of Connecticut, at a pretrial conference, said:

> "The New Haven, Debtor, as it appears to me is acting in a fidicuary capacity, primarily for junior equities although in a broader sense for all the composit securities."

In No. 8930 in the Circuit Court of Appeals for the Seventh Circuit the Debtor (Chicago, Rock Island and Pacific Ry. Co.) has appealed from the order of the district court approving the Commission's Plan of Reorganization. A motion to dismiss the appeal was made on the ground that the errors alleged by the debtor were presented in behalf of certain dissatisfied creditors. The court upheld the right of the debtor to represent such creditors and denied a motion to dismiss.

Section 77 (c) (13) provides that "the debtor • • • shall have the right to be heard on all questions arising in the proceeding."

In this case the Eighth Circuit says:

> "As compared with the claims of bondholders their claims are so small that their share would be negligible if indeed not infinitesimal."

The extent to which the total of unsecured claims represented dominated the court's' judgment is not made clear. It is evident that $21,500 might be too unimportant to justify investigation of the problem involved, but $400,000 is not

If, however, the Circuit Court of Appeals means to hold that $1,000,000 or more of cash accumulated and in hand before the Debtor's property was put in *custodia legis* and any demand for the impounding of income was made, will be absorbed by deficiency claims in favor of secured creditors and that the amount of such claims can be determined without compliance with the terms of the mortgage indentures which require foreclosure, then the problem is involved in the problem of interest as between creditors.

A solution of this question requires that asset value must be set off against the principal of the creditor's claims as of May 16, 1933. These problems are referred to under Question 3 and in a solution of these problems the right of the Debtor to represent unsecured creditors is extremely important.

**Question 3.**

Section 77 is a bankruptcy act. It as held to be constitutional because it rested on bankruptcy powers.*

The bankruptcy court, through its trustees, is given title to debtor's assets in trust for the creditors and the debtor. Equitable title *in rem* are created and attach on the filing of the petition. The bankruptcy court has ancient administrative principles and processes for the administration of all debtor's assets that come into its hands. These are designed to insure equality and uniformity. Nothing in Section 77 disturbs those processes so far as they affect the preservation of debtor's assets, the adjudication of claims and the application to such claims of distributions made to creditors.

If a Plan of Reorganization results, the rights of creditors to distribution may be satisfied by allotting securities in a going corporation. *This is not liquidation.* The creditors' claims are what *at the end of bankruptcy administration* they are found to be. They may or may not be reduced during administration. The debtor's assets may be much more or less valuable. The rights of the parties—the basis of distribution—are adjusted to the date of filing the petition.†

The proceeding may not produce a Plan. If not, the property will be turned back to the debtor. But the court of bankruptcy which handles it *pendente lite* should, we believe, exercise its powers to the fullest, not only the normal powers but any extraordinary powers given to it by

* *Continental National Bank v. Rock Island*, 294 U. S. 648, 79 Law Ed. 1110.

† Section 77 (1).

Section 77, in order to facilitate the objective specially stated in Section 73.*

Under Section 77 the court is given extraordinary power to act for the benefit of the estate for the relief of debtors and in the public interest. If such extraordinary powers are used to that purpose they could, where necessary, modify the normal rules of administration. If normal rules in bankruptcy or equity can be used to further the important purpose of the extraordinary powers it would seem to be the duty of the court to so use them.

Our eyes cannot be shut to the fact that both the House and Senate are severely critical of the ruthless treatment of unsecured creditors and debtors in cases so far closed and cases in process of being similarly treated.†

The obvious lack of equity in these Plans was noted by Judge Phillips in his Special Concurring Opinion in the D&RG case.‡ Judge Evans of the Seventh Circuit on the argument of a motion to dismiss the appeal of the District Court's approval of the Rock Island Plan used the remarks printed as Appendix D to this brief. In earlier decisions Judge Evans followed meticulously the language of this Court as he understood it when he participated in the confirmation of the Chicago, Milwaukee & St. Paul and the Chicago Northwestern Plans. His language in those cases has greatly influenced the decisions of other courts. He is now troubled with the gravest doubts.

As the lower courts read the decisions of this Court there is not the remotest opportunity to give relief to debtors so long as the Depression conditions from which relief was promised are used as a dominant or even important basis for estimating the future worth of railroads in Section 77. In fact, if applied to many roads not in 77

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* "* * * courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors." (§73 of Bankruptcy Act.)

† In the House see Report of House Judiciary Committee No. 1615 dated June 8, 1944, in support of the Hobbs Bill which has passed the House. In the Senate see Senate Report 952 on Senate Bill 1253 which is epitomized in Appendix B hereto.

‡ (150 Fed. 2d 28.)

the estimated earnings capitalized as the Commission does, it would show a large deficit in assets compared to debts.*

But if the decisions of this Court were not believed to paralyze the bankruptcy powers, both normal and extraordinary, given to be used to relieve the Debtor in the same plenary manner in which the Debtor itself could act, the debt structure of the Frisco and other roads could be altered, no one forced to take less of cash or security than he or his class might agree to, and the properties would be ready to turn back to the Debtor. At least an effort could have been made with as great a promise of success as was reached by the roads not under 77.† This is true even on the basis of Depression values and more clearly evident on presently demonstrated values.

As the language used by this Court has been read and followed, the lower courts have felt compelled to accept the Commission assumption of worth, hence they have seen no alternative but to pay all admitted debts (compromise and allow disputed claims) either in cash or new securities after accumulating interest at contract rates. They have insisted on paying par and interest to creditors who were constantly disposing of their claims on the market at huge discounts.‡

Furthermore, the "brigading" of court and Commission left large gaps in the definition of their respective powers. The result has been that a "Depression valuation" of Debtor's assets which later events showed to be ridiculously low but which has received court "approval" has not been changed because the Commission waits for the court's direction and the court feels powerless to require a correction of the Commission's figures.§

In the earlier stages of the statute's operation and at the time this court considered the cases before it, the part

* Courts continue to treat the Commission's capitalization as representative of some value. In some cases it clearly fluctuates in relation to debts and not in relation to any kind of value for the property.

† See Senate Report, pages 85, 88, 89, Appendix B.

‡ See Senate Report, page 79, Appendix B.

§ See Senate Report, page 88, Appendix B.

of the court in administering the estate was not a major concern. The Depression earnings furnished little ammunition with which to accomplish the necessary debt adjustment preliminary to a final Plan or as a part thereof.

The last five or six years have provided huge earnings with which to do the job. This Court never has had before it the problems of administration presented by the opportunity to use such sums for Debtor's benefit. In this Frisco case $135,000,000 of earnings and $49,000,000 of depreciation reserve have been available to the trustees and would have been available to the Debtor to make necessary adjustments and reformations in the debt structure.

In this Frisco case most of the lowest interest bearing debt (equipment trusts) was paid at par and interest. This cash could have been much more beneficially used and equipment trusts refunded.

Some senior bonds, par and interest, were paid. Interest included in the principal of certain claims was paid in a small amount. This was helpful. Compromise was made with the RFC and the RCC. The compromise was initiated by the creditors and no one objected. It was a beneficial transaction but comparatively small in amount.

Huge blocks of bonds were purchasable in the market at large discount which, if made, would have wiped out the principal of the bonds and large interest accumulations.*

Speculators were allowed to buy bonds which the holders were *willing* to sell but this Debtor's assets and earnings were held in "chancery" and not used for its benefit and for the strengthening of unretired bonds. It has been helpless and paralyzed. There is yet in the hands of the court's Trustee more than $30,000,000 which can be used to carry out such policy. Courts of equity should be able to devise a way to provide for the recoupment of the damage that has been done to the Debtor and give it benefits in interest adjustments which it should have received.

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* See Senate Report page 85, Appendix B.

We make this statement of the situation encouraged by the support given in the Report filed by Senators Wheeler and Reed on behalf of the Senate Interstate Commerce Committee. We have epitomized that report in Appendix B to this brief. We submit that this Court did not intend to paralyze the courts in that field of the bankruptcy courts' administrative powers by any ruling it has heretofore made.

**Question 3(a).**

If at the end of the court's administration the assets in the hands of the court exceed the principal of all claims—as they do in this case—can unsecured creditors be cut out by the accumulation of interest *pendente lite* in favor of secured creditors?

Let it be admitted that some equitable allowance of interest, either in full or adjusted to the circumstances of the case, must be recognized before anything can be allowed to the Debtor.

As between creditors there is no right to seize the *in rem* right of any creditor accrued to him as of the date the Debtor's petition was filed (May 16, 1933) to pay interest to another creditor.

*Sexton v. Dreyfus,* (219 U.S. 339) held specifically that a secured creditor could not even take his security out of the court's hands and apply any of the proceeds to interest *pendente lite* before computing a deficiency claim, that to permit this to be done would be to permit the accrual of interest to increase the deficiency claim and that bankruptcy would not permit this to be done as against other creditors.

No ruling of this Court has changed this rule.

"Claims" in bankruptcy are the claims which share in common assets. Secured creditors may waive their security and have a "claim" for their whole debt, or they may realize on their security in accordance with the provisions of the bankruptcy act and possibly have a "claim"

for deficiency. Judge Walter H. Sanborn of the Eighth Circuit* said:

> "* * * the status of claims at the time of the filing of the petition in bankruptcy and not at any subsequent time fixes the rights of their owners to share in the distribution of the estate of the bankrupt."

Judge Vann of the Court of Appeals of New York† in an equity case stated the rule and gave the reasons fully.

> "If the funds in the hands of the court could have been distributed on the same day that the receiver was appointed, no claim of interest could have arisen, for there would have been no delay and no suspension of legal remedies. The delay in distribution, however, was the act of the law itself, and was essential for various purposes and among others to enable the creditors to prove their claims. (As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds.) *Thomas v. Western Car Co.*, 149 U.S. 116.) Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets. If the assets are sufficient to pay all, including interest, it must be paid, for as against the corporation itself interest should be allowed before the return of any surplus to the stockholders. As between the creditors themselves, however, no interest should be allowed during the process of administration, and the delay necessarily resulting therefrom, because the assets are equitably their assets, the administration is for their benefit and the delay is necessary to enable them to take action to present their claims in proper form, as well as to enable the court to put the assets in shape for distribution.
>
> "As the decree of dissolution relates back to the

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* *Kansas v. Hurley et al.*, 169 Fed. Rep. 92.

† *People v. American Loan & Trust Co.*, 172 N. Y. 371.

day when the court took possession of the assets, the delay is not the act or omission of the corporation, which is *civiliter mortuus*, but is owing to the law and hence should operate neither to benefit nor prejudice any creditor. Distribution should be made as of the date when the delay began, for it was not only caused by the law but was necessary for the protection of all classes of creditors. As between the creditors themselves, therefore, interest ceases to accrue upon their respective claims, whether preferred or unpreferred, from the day when the corporation let go and the court took hold. This rule is so simple and easy of application that it will not only tend to prevent litigation, but will stimulate all creditors to frown upon delay and to promptly call the receiver to account. It will not unduce preferred creditors to rest easy in reliance upon the expectation that they will make money through the misfortune of the corporation and, during the entire period of administration, receive interest at a greater rate than they had contracted for."

At this writing it appears to us that this Court has not held otherwise.

Only secured creditors who seek the exclusive benefit of their security and do not seek to share in the assets upon which they have no lien (except for a deficiency) can have interest *pendente lite* out of the proceeds of that security as against other creditors. Nothing in Section 77 can be pointed out which abrogates this rule. We submit that this rule is a bankruptcy rule which has the same reason for surviving as the rule referred to by this Court in *Young v. Higby.**

**Question 3(b).**

The secured creditors have impounded the income from their respective divisions and their liens attached to the earnings. The $1,000,000 delivered by the Debtor to the

* (89 Supreme Court Law Ed. No. 9, 578.)

Receivers appointed November 1, 1932 would not be made subject to the lien by the impounding order.

If the mortgage creditors should foreclose their mortgage and mature a deficiency they could rightfully claim for the deficiency with the unsecured creditors. Or they may waive their secured position and share with other creditors in all assets. They will hardly waive their security.

Pending a Plan the secured creditors are not required to make any election nor would they willingly accept a Plan which did not recognize their debts and priorities as they may be at the end of administration. Thereby they retain their secured position. We do not understand that they are "preferred" creditors in bankruptcy. Neither have they conditioned their debts for any deficiency claim.

Evidently the Circuit Court of Appeals believes that what this Court has said abrogates the applicable bankruptcy rules. If so, this Court has held that appraisement and fiat may take the place of the right of unsecured creditors to have deficiencies determined through foreclosure as provided in the mortgage indentures and that a deficit may be estimated and that the unsecured creditors may be overwhelmed as a result of such estimate, and that this can be done without the finding of dollar values.

We believe this Court has not so held and submit that that it should not do so.

**Question 3(c).**

It seems to be the settled law of bankruptcy administration that no attention need be paid to interest *pendente lite* until the principal of all creditors' claims is paid. If assets (cash) are distributed by the court they are first applied to the payment of principal of all claims. No interest should be paid until that principal is all paid. This is a just application of payments because failure to do so may result in final orders which forfeit the interest of some beneficiary of the court's administration.

Out of the earnings $63,000,000 was paid to secured creditors. It was not applied on principal.

The creditors have impounded as part of their security $135,000,000 of earnings and have a right to demand the earnings of the court unless the court withholds the earnings for the purpose of carrying out its policies.

We submit that it is just that the entire earnings be charged to the creditors as payment on the principal. If the bankruptcy court keeps a part of the earnings to carry on its program it borrows it. This is the reality. The bankruptcy court then has the power and right to fix the rate of interest on the borrowed money at the rate at which it could obtain it in the market. On that theory the bankruptcy court has borrowed in excess of $70,000,000 from the creditors and it should fix the rate of interest that it will allow, and it should allow no more than the market rate at which it could borrow on the security of the assets in its hands. Instead of treating the accounts in that way the bankruptcy court has allowed the debts of the secured creditors to stand unreduced by the earnings and to accumulate interest at the contract rates, which are substantially in excess of the market available to the bankruptcy court. That court believes this course to be necessary because of the decisions of this Court. We submit that no such result was intended.

**Question 3(d).**

The Wheeler-Reed Report has graphically demonstrated that had it not been for debt maturities fixed long years ago and fortuitously falling at unfortunate dates, many of the roads that had to seek refuge in Section 77 would have been free to utilize the Adjustment Act* or act without the cooperation of the Interstate Commerce Commission and refund and readjust their debt and capital structure and escape disaster.†

We submit that the extraordinary powers given to

* 11 U. S. C. A., § 1200-1255.

† Senate Report, page 57, Appendix B.

bankruptcy courts under Section 77 could have been utilized to bring about the same beneficient results that were accomplished by companies outside that jurisdiction. The reason it has not been done is because the bankruptcy courts have interpreted the decisions of this Court to mean that they cannot do it.

By Section 77(b) authority is given to modify or alter the rights of creditors generally or of any class of them, secured or unsecured, either through the issuance of new securities of any character, or otherwise. Like powers as to stockholders are given. There is no thing that a debtor can do that the court is not authorized to do by means of a Plan. There is nothing which requires everything to be done at once, or changes to be put into effect at one and the same time.

By subsection (c) (2) all the title is put in the court's trustees. Under subsection (g) the court is given broad power in dismissing the proceedings if administration does not proceed with reasonable speed, and he is the judge of what is "reasonably expeditious".

There was a first time when a railroad came into the custody of a court. That court was faced with a "public interest" in the handling of the property. Strong chancellors in equity had no difficulty in concluding that it must satisfy that public interest and that it could pledge all the assets in its hands to accomplish that purpose.

Under Section 77 the "public interest" extends to "financial engineering" and full powers are given to the court to handle the problem. By extending the principle long recognized to the newly declared public interest there is ample power under 77 to do anything the Debtor could do to readjust the finances and use the assets in the court's hands to secure capital for that purpose.

At all times it has been possible within the powers given the court for the trustees to negotiate refundings, purchases, alteration of securities, and to sell refunding bonds at reduced interest rates to those willing to purchase

or exchange them for existing bonds, or to buy in the market the bonds which as the Senate Committee demonstrates* the holders were willing to sell, or exchange new securities with willing holders of the old securities. Up to the middle of the Depression the Trustees were not in funds. Undoubtedly it needs cash to be used in making such adjustments but since cash has been accumulating no steps have been taken except to pay off low interest bearing securities and prior claims at par and interest. These transactions are no relief at all to debtors who are frozen and paralyzed by their inability to handle their own assets. These things have not been done by the trustees or the courts because they have read the decisions of this Court to mean that there is nothing to do but to provide out of the assets for the payment in full as far as the assets will stretch of the principal and interest of secured claims.

If this Court did not mean to so confine the bankruptcy court, it is not too late to accomplish, through a decision by this Court, all the beneficial relief that the House and Senate are seeking to accomplish through new legislation.

**Question 3(e).**

A reference to page 286 of the Appendix to the joint brief of appelles filed in the Circuit Court of Appeals of the Eighth Circuit shows the response which the Commission made to a request of the Debtor for findings of fact. This request was made in order that the factual basis on which the Commission acted in expropriating Debtor's property might be clearly disclosed. Previously the Commission had used general findings of the type now prohibited to Federal Courts by Rule 52a Federal Rules of Civil Procedure. We believe the answer to the findings discloses that no factual basis except some assumption as to future earnings was so used.† We are referred in the answer to the request for a finding as to future earnings to the report itself and we find there no definite estimate of future earnings.

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* Senate Report pages 83-85, Appendix B.

† Appellees' Appendix page 286.

It is true that the Commission heard all evidence that was offered. Not a witness made an estimate of future earnings lower than $23,000,000 in distributable earnings before the deduction of State and Federal income and excess profits taxes. It is certain that the testimony of these witnesses was not accepted. If the Commission arrived at any other notion as to future earnings it was due to some knowledge of their own not disclosed on the record. We believe the process was exactly the same as the fact finding process condemned by this Court in *Carter v. Kubler.*•

The Debtor asked the District Court and again the Court of Appeals to look at the testimony and see what evidence supported such an assumption of value as the Commission made. It was not in the book record of investments, it was not in reproduction cost less accrued depreciation, it was not in the record of normal earnings which had shown an excess of $9,000,000 a year over fixed charges. It could have been in Depression earnings but the use of Depression earnings as a sole or dominant basis flouts the very object of Section 77. No relief is possible for any road subject to that jurisdiction if its future is measured by the Depression. An examination of the findings of the Commission shows that the assumed value could have no relation to any factor except the assumed future earnings based on the Commission's guess.

In recent testimony before the Senate Interstate Commerce Committee Commissioner Porter testified† as follows:

> The process is one of "making intelligent guesses. For this purpose we studied the past history that was before us, we had the testimony of men who were regarded as in a position to make the most intelligent guess as to what the future might hold and starting from that complete record up to the minute that it was submitted to us we tried to make up our minds as best we could on that."

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• (320 U. S. 43.)

† Senate Report, page 65, App. B.

In the case of the Frisco the Commission did not have the testimony of anyone giving a guess as to the future earnings at a level less than the $23,000,000 per year before income and excess profits taxes.

Both of the courts below showed that they made no investigation of the testimony. The Circuit Court of Appeals expresses the attitude towards the problem as follows:

> "In view of the very extensive investigation by the Commission of every element or factor having any conceivable bearing on the question of future earning capacity, including the condition and nature of the physical properties, the past earnings record and all circumstances which bear upon the question of future earnings or value it cannot reasonably be said that the Commission assumed anything."

It is obvious that any conclusion as to future earnings is an assumption. In one sense an assumption of future earnings is not subject to judicial proof.

Is it true that large property interests can be expropriated on such an assumption without even a word of testimony by any witness as to what, in the judgment of the witness, those earnings might be? If so, it means that property can be expropriated (permanently) on an administrative guess inherently quarantined from court review. If it be true, then the Circuit Court of Appeals did state the rule, only in other language. And it might be stated in another way, to-wit:

> If the administrative body took all the evidence there was, their conclusion is final and the court has no duty to examine the evidence and see whether there is anything to support it on the record.

We do not believe that this Court has intended that result. We do not believe it has relieved the District Court and the Circuit Court of Appeals of the duty to examine the evidence and determine whether all the evidence does or

does not establish a factual basis for the factual guess upon which expropriation is predicted.

There is another and germane question involved. A court of equity will not forfeit anyone's interest unless the factual basis is clearly proved. It abhors forfeiture. It will not participate in the creation of conditions which result in forfeiture.

Does the fact that the evidence upon which a forfeiture is to be predicated is first heard by an administrative body force the court of equity into a position where it must abandon its salutary rule and accept a scintilla in place of clear proof?

We humbly ask that this Court unfreeze the lower courts and let them operate as courts of bankruptcy and equity in the administration of the railroads in their possession. There are vital functions to be performed for the benefit of the Debtor that the Interstate Commerce Commission is not officially qualified to perform and we believe does not wish the responsibility of performing.

**Question 4.**

The readjustment of a debtor's affairs by the process of composition in bankruptcy is traditional and well understood. An essential of that proceeding is the assent of the debtor and the assent of adequately represented creditors. Proceedings under Section 77 have progressed on the fiat basis. Parties rights are threatened with alteration or complete destruction without their consent.

We are well aware that this Court has clearly indicated in the *Ecker* and *Milwaukee* cases that it saw no violation of the Fifth Amendment either for lack of due process or because of confiscation in the public interest

If the debtor's property may be taken without its consent the rights of creditors can be changed without their consent, at least it would so appear. The *Ecker* and *Mil-*

*waukee* decisions were made on approval orders. Those orders disposed of no one's property. At the time those cases were presented the patries had their own reasons for presenting the cases to this Court as they did.

The petitioner is also here on an approval order but because it has to do so, so long as the appeal from the Order of Confirmation stands undisposed of.

We believe that it would be salutary if this Court should indicate that it does not consider that it has determined the constitutional questions that would be directly and clearly presented on a consideration of a dispositive order of confirmation.

## CONCLUSION

Because the courts of bankruptcy and the Circuit Courts of Appeals have understood the decisions of this Court to forbid administrative activities by the courts in the field of debt adjustment beyond the function of considering a Plan of Reorganization certified by the Commission which leaves no alternative but the satisfaction of all claims with legal interest in full accrued *pendente lite* (as far as the assets of Debtor will reach),

a. Unsecured creditors are cut out by the accumulation of legal interest *pendente lite;*

b. Debtors are thereby submerged under a great burden of accrued interest and denied an opportunity through the use of assets to have both principal and interest of debts discounted.

It is of great importance to the just and orderly progress of proceedings under Section 77 that the bankruptcy courts should be instructed as to their powers and duties in the premises.

The practice and procedure in the hearing and determination of the rights of parties should be clarified. A final consideration of an order of confirmation should be

the judicial act prerequisite to the divestment of the rights of any party or the investment of rights in others.

We respectfully pray that this petition should be granted.

Respectfully,

WILLIAM V. HODGES,
947 Equtable Bldg., Denver, Colorado,

DANIEL BARTLETT,
506 Olive St., St. Louis, Missouri,

*Attorneys for St. Louis-San Francisco Railway Company.*

C. O. INMAN,
721 Olive St., St. Louis, Missouri,

PHIL W. DAVIS, JR.,
W. N. MABEN,
613 Daniel Bldg., Tulsa, Oklahoma,

*Attorneys for Lola Brooks, Adm'x, and John E. Dikis, Adm'r.*

## APPENDIX A

*Section 73 of Bankruptcy Act* (11 USCA Sec. 201)

### ADDITIONAL JURISDICTION

In addition to the jurisdiction exercised in voluntary and involuntary proceedings to adjudge persons bankrupt, courts of bankruptcy shall exercise original jurisdiction in proceedings for the relief of debtors, as provided in sections 202, 203, and 205 of this chapter.

*Excerpts from Section 77 of Bankruptcy Act*

(11 USCA Sec. 205)

**REORGANIZATION OF RAILROADS ENGAGED IN INTERSTATE COMMERCE—PETITION FOR REORGANIZATION BY RAILROAD, SUBSIDIARY OR CREDITORS; VENUE; PROCEEDINGS THEREON; JURISDICTION OF COURT OVER DEBTOR AND PROPERTY . . . .**

**Plan of reorganization, contents; "securities", "stockholders", "creditors", "claims" defined; suspension of statutes of limitation.**

(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such amount that, after due

consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, the amendment of the charter of the debtor, and/or the issuance of securities of either the debtor or any such other corporation or corporations for cash, or in exchange for existing securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted. The term "securities" shall include evidence of indebtedness either secured or unsecured, bonds, stock, certificates of beneficial interest therein, certificates of beneficial interest in property, options, and war-

rants to receive, or to subscribe for, securities. The term "stockholders" shall include the holders of voting-trust certificates. The term "creditors" shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

The term "claims" includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors. In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. The provisions of section 96 of this title shall apply to a proceeding under this section. For all purposes of this section any creditor or stockholder may act in person or by an attorney at law or by a duly authorized agent or committee subject to the provisions of subsection (p) of this section. The running of all statutes of limitation shall be suspended during the pendency of a proceeding under this section.

**Proceedings after approval of petition.**

(c) . . .

(2) . . .

The trustee or trustees so appointed, upon filing such bond, shall have all the title and shall exercise, subject to the control of the judge and consistently with the provisions of this section, all of the powers of a trustee appointed pursuant to section 72 or any other section of this title, and, to the extent not inconsistent with this section, if authorized by the judge, the powers of a receiver in an equity proceeding, and, subject to the control of the judge and the jurisdiction of the Commission as provided by chapter 1 of Title 49 as on August 27, 1935, or thereafter amended, the power to operate the business of the debtor. Prior to the appointment of a trustee, the debtor on behalf of the court shall continue in the possession of the property and shall operate the business thereof during such period, and shall have all the title to the property and shall exercise all power consistent with the provisions of this section subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as he may from time to time impose and prescribe . . . .

(10) The judge may direct the debtor or the trustee or trustees to keep such records and accounts, in addition to the accounts prescribed by the Commission, as will permit of such a segregation and allocation, as the necessities of the case may require, of the earnings and expenses between and to the divisions and parts of the railroad or other property of the debtor which are separately subject to the liens of the various mortgages or deeds of trust, or are separately subject to lease, and may refer to the Commission for its recommendations after hearings thereon if the parties shall so request and/or the Commission determine necessary or desirable, as to the method or formula by which such segregation and allocation shall be made; and thereafter such segregation and allocation may be made at the expense of the debtor's estate. . . .

**Court hearing after approval by Commission; acceptance of plan by creditors and stockholders; confirmation of plan by court; valuation of property.**

(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) it complies with the provision of subsection (b) of this section, if fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an

opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided*, That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding that the interests of such class of creditors will be adversely and materially affected by the plan, or that at the time of the find-

ing the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satified that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of the stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: . . . .

If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further

proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.

**Binding effect of confirmation; discharge of debtor from liabilities; issuance of securities.**

(f) Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders thereof, including those who have not, as well as those who have, accepted it, and all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and if filed, whether or not approved, including creditors who have not, as well as those who have accepted it. Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative thereto, under and subject to the supervision and the control of the judge, the laws of any State or the decision or order of

any State authority to the contrary notwithstanding. The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provision of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, and the judge may require the trustee or trustees appointed hereunder, the debtor, any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may require the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. Upon confirmation of a plan the Commission shall, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of chapter 1 of Title 49 as on August 27, 1935, or thereafter amended. . . .

**Dismissal of proceedings because of undue delay in reorganization.**

(g) If in the light of all the existing circumstances there is undue delay in a reasonably expeditious reorganization of the debtor, the judge, in his discretion, shall, on motion of any party in interest or on his own motion, after hearing and after consideration of the recommendation of the Commission, dismiss the proceedings. Upon the filing of such an order of dismissal, all right, title, or interest of the trustee or trustees shall vest by operation of law in the debtor unless otherwise provided by such order. . . .

**Restraining or staying commencement or continuation of proceedings against debtor; removal of causes; owners' rights to equipment leased or conditionally sold unaffected.**

(j) In addition to the provisions of section 29 of this title for the staying of pending suits against the debtor, the judge may enjoin or stay the commencement or continuation of suits against the debtor until after final decree; and may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree: . . . .

**Certified copy of order confirming plan or directing conveyance of property as evidence.**

(k) A certified copy of the final order confirming a plan of reorganization, or of any other order or decree entered in a proceeding under this section, shall be evidence of the jurisdiction of the court, the regularity of the proceedings, and the fact that the order or decree was made. A certified copy of an order directing the transfer and conveyance of the property dealt with by the plan as provided in subsection (f) of this section, or as specified in an order dismissing the proceedings as provided in subsection (i), shall be evidence of the transfer and conveyance of title accordingly, and if recorded shall impart the same notice that a deed, if recorded, would impart.

**Jurisdiction of court, duties of debtor and rights of creditors same as in voluntary bankruptcy.**

(l) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed. . . .

**APPENDIX B**

**Excerpts from Report No. 925 (Senate) 79th Congress 2nd Session, February 7, 1946.**

**Investigation of Trusteeships under Section 77 of the Bankruptcy Act and Railroad Equity Receiverships.**

**We apply italics for emphasis.**

**Pagings conform to the pagings of the report.**

**All tables have been condensed to apply only to St. Louis-San Francisco Ry. Co.**

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**ADDITIONS AND IMPROVEMENTS TO THE TRANSPORTATION PLANT OF THE RAILROADS**

The investment per mile of road has increased from approximately $80,000 per mile of road at the end of Federal control to $111,352 at the beginning of the calendar year 1942. This increase is in large part attributable to expenditures for heavier rail, more and improved signal systems, larger and more efficient equipment and machinery, and in no small part to the elimination of some 25,000 miles of the least efficient lines, whose abandonment we had authorized as consistent with public convenience and necessity (pp. 2-3).

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**THE PHYSICAL PLANT DURING THE DEPRESSION YEARS**

In the case of both the railroads in the hands of the court and those which have remained out of receivership and bankruptcy proceedings, heavy investments in improvements and additions as well as in maintenance, in the war years, have now brought the railroad plant to a higher level.

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**REDUCTION OF DEBT**

The Interstate Commerce Commission reported to Congress:

During the period January 1, 1932, to December 31, 1941, the funded debt of class I railroads was reduced from $10,850,944,438 to $10,565,084,210, a decrease of $285,860,228. Of this reduction, at least $111,115,727 was effected through reorganization (annual report for 1942, p. 28).

At present, a large proportion of the outstanding railroad bonds can be bought at large discounts. This affords a most favorable opportunity to eliminate debt and to cut fixed charges. The extent to which railroads are now buying their own bonds is not currently reported, but the indications are that substantial operations of this character are, and have lately been, in progress (same, p. 29).

In our last annual report, we again discussed the importance of debt reduction. We suggested that the present favorable earnings be used as largely as is practicable for that purpose. We are convinced that both the public interest and the interest of carrier shareholders will in the long run be served by that policy (same).

For the year 1942 the Commission reported:

It is gratifying to report that more and more railroads in a position to do so are voluntarily reducing or taking steps looking toward the gradual reduction of their funded debt and the burden of fixed interest charges. Some are using their surplus earnings to retire a part of their funded debt or to purchase on the open market their own outstanding securities or those of their subsidiaries which they have guaranteed. During the calendar year 1942 the funded debt of class I railroads and their lessors, excluding companies in receivership or trusteeship, was reduced by $324,375,299, or 3.71 percent. For the operating companies alone the reduction was $282,026,921, or 3.84 percent, and for lessors $42,348,378 or 3.02 percent (annual report for 1943, p. 25).

The Commission's recent annual report states:

> At the close of the year 1935 the amount of unmatured funded debt, including equipment obligations, of line-haul steam railways held by the public (that portion not held by railways) was $11,341,000,000 as compared with $9,312,000,000, as of December 31, 1944, or a reduction in the 10-year period of $2,029,000,000 or 17.9 percent (annual report for 1945, pp. 19-20).

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The report published by the Association of American Railroads in March 1944 and prepared for one of its committees, shows that the funded debt of railways of classes I, II, and III reached a peak of $11,880,000,000 in 1930 and was gradually reduced thereafter, falling to $10,354,000,000 in 1942,, or a reduction in those 12 years of more than one and one-half billion dollars (report, p. 10).

In addition it should be recalled, as noted above, that a number of railways have in recent years been generally making additions and betterments to their properties on a cash basis and without following the usual practice of selling securities to meet the cost of such additions and betterments.

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On the basis of this estimate, the improvement in the position of the carriers in the past 4 years may be totaled, as follows:

| | |
|---|---|
| Increase in net working capital (p. 3 of Monthly Comment) ..... | $1,125,667,235 |
| Estimated increase due to the 2 tax provisions, and profits of the closing 4 months for 1945, at least..... | 1,000,000,000 |
| Total ..... | 2,125,667,235 |

This amount constitutes almost one-fourth of the bond debt of the carriers.

This amount can be used to retire outstanding debt. Very little is likely to be used for capital expenditures. The carriers were polled by the Bureau of Transportation Economics and Statistics of the Commission, and reported that they were expected to spend $1,636,000,000 for road and equipment in the 3 years following the end of the war in Europe and Asia; they reported that they expected to use little of their wartime and prewar earnings to finance such expenditures. (Monthly Comment on Transportation Statistics, December 10, 1945, pp. 1-2.)

**REDUCTION IN INTEREST CHARGES AND RATE OF INTEREST**

One of the most promising developments for the railroads has been the substantial drop in the cost of money. The United States Government led the way in financing during World War II. The rate of interest for Liberty bonds in World War I was 4¼ percent. In World War II, the rate for long-term financing has been 2½ percent, and as low as 2 percent; the average cost of long- and short-term financing for the Government has been below 2 percent—this in spite of the fact that far larger sums have been borrowed to finance World War II than World War I. The money market is aggressively reducing the yield on the 2- and 2½-percent bonds; their market price is above par, and on many days the increase in price has been the full maximum amount permitted by Government regulations.

Privately owned corporations have benefited from similar reductions in the interest rate on their long-term financing. There has been a large volume of refunding at 3 percent, 2⅞ percent, 2¾ percent, and 2½ percent.

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Interest rates on railroad debt are likely to continue to decline, by reason of a second factor additional to the general decline in interest levels. The large amount of sur plus cash which the railroads possess means that a substantial portion of the outstanding railroad debt will be

retired. *This means that the bonds remaining after such retirement will be both better and scarcer. They will be better because each remaining bon dis secured by more collateral or mortgage value than before, and has access to a larger proportion of the earnings than before. Many of the remaining bonds will also be better because the retirement process has raised their level of seniority.* Retirement of senior bonds converts the junior bonds below them into first mortgage bonds; and so on down the hierarchy of a company's debt. The better the unretired portion of a company's bonds becomes the lower the rate of interest which that company can require in the investment market.

A similar result flows from the other factor already mentioned, the reduced supply of railroad bonds and indeed of all bonds.

The process of refunding to a lower level interest rate will effect a financial change of magnitude for the railroads; the extent of the change is indicated by basic figures published by the Western Railways and by the Eastern Railroad Presidents Conference in the 1944 edition of A Yearbook of Railroad Information (pp. 22, 42). These figures show that the total funded debt of the class I railways in 1942 (the latest year listed in those statistics) was $10,354,041,681 and that the total interest in that year on funded debt was $483,000,000. This constitutes an average interest rate slightly in excess of 4.65 percent. A cut of the average interest rate of 4 percent would effect a reduction in the annual interest charges of $68,336,000. A cut to 3½ percent would reduce the annual interest charge $118,513,000. A cut to 3¼ percent would reduce the charge by $143,601,000. A cut to 3 percent would effect a reduction in the annual interest charges of $168,689,000.

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On the subject of possible savings in interest charges, this committee has received from the Interstate Commerce Commission, in response to our request, data on 23 roads

now in the hands of the Federal courts, or recently undergoing reorganization proceedings. Nine of the largest of these companies are still in court hands, in receivership or trusteeship; a tenth has emerged or is in the process of emerging from court hands; their aggregate operated mileage, as reported by the Commission (annual report for 1944, p. 146) is some 43,340 miles; if their interest charges were reduced to 3¼ percent (the "lower level rate" or average interest rate of the railway bond flotations between January 1, 1944, and June 30, 1945), those 10 systems would save about $30,205,000 per year. The amount of such potential annual savings, and the percent by which the 1944 total annual interest charges would be reduced through such savings, are here given for each of the 10 companies:

| Name of company | Annual savings in charges if interest on bonds were reduced to lower level rate | Percentage of reduction of present total interest charges |
|---|---|---|
| • • • • • | | |
| St. Louis-SanFrancisco Ry. Co. | $3,094,386 | 26 |

Source: ICC, table VI, C. 8.

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The completion of the program of reducing the interest rate paid by these and all other railways will constitute a fundamental reorganization of their finances. It can produce financial changes adequate for the needs of the railroads. *The process, furthermore, is in contrast to the drastic process usually involved in reorganizations in equity receivership and under section 77 of the Bankruptcy Act. It is a business process in contrast to a Government-imposed process. It stems from the market place rather than from governmental agencies. The possibility of effectuating such a program may well be regarded as one of the greatest assets of the railroad industry.*

However, in a number of these railroads this process could have been carried much further. A number of receivers and trustees have been inclined to hold cash and cash equivalents in far larger amounts than were needed or could be justified by sound business practice. It is necessary to convert more rapidly from the theory and practice in insolvency proceedings of withholding payment of interest and retirement of bonds, to the sound business practice of paying interest and retiring principal when funds are available for those purposes. It is now clear that the conversion to the normal process of paying interest, past and current, and retirement of principal, can be carried much further than has been the case up to the present.

Sound railroad finance requires the prompt retirement of debt through the use of the over-abundant funds which are now being held by many of the receivers and

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trustees appointed by the Federal courts. It is true that the receivers and trustees invest a portion of their large surplus funds in short-term government obligations which yield a fraction of 1 percent per year. However, the receivers and trustees are in a position to retire large amounts of debt, bearing coupons of 4 to 6 percent. The net loss to the railroads is, therefore, considerable—and unnecessary. *It is possible that some receivers and trustees have found it difficult to use the surplus funds as fully as they might have desired because they felt that this might interfere with some pending plans of reorganization or with negotiations among groups of security holders. However, no such circumstances would seem to justify a departure from the requirements of sound business practice which should govern all such questions. The reorganization plans are subject to revision, and even to abandonment, as experience demonstrates; legislation may affect their course also.*

***Meantime unnecessary interest charges accrue, or are paid. The industry can be greatly advantaged by using the surplus funds without further delay, for reduction of debt.***

| | Net interest rate which could have been saved | Net amount of interest which could have been saved, computed on an annual basis |
|---|---|---|
| | *Percent* | |
| • • • • • | | |
| St. Louis-San Francisco | 3.83 | $591,532 |

Source: ICC table VI, C 5 (8).

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The amount of surplus funds, available for reduction of debt, is far larger today than it was at the end of 1944; and the amount of interest charges which could be saved if the surplus were energetically applied to retirement of debt is far larger than in 1944. Reference has already been made to the large cash accumulations of 1945, resulting from the net income of that year, and the tax provisions with respect to amortization and refund of 10 percent of excess-profits taxes.

Reference was made above to the payment of interest charges, both current and accured, by companies in the hands of the courts. Large amounts have been paid by the trustees and receivers, pursuant to court orders. Justice to the bondholders required such action, and entitled them to have such payments made larger, in order to clear up all arrears, and to provide income to junior bondholders, where they have received no payments of interest, or relatively small amounts of interest.

*However, justice to the companies and their shareholders makes some adjustment appropriate.* The Reconstruction Finance Corporation has already pointed to *the fair course, that of reducing the amount of interest demanded by it, from the full figure fixed in its notes, to a lower rate made appropriate by financial conditions, usually for 6 percent to 4 percent; and, as we note later, this process might even be carried further, in full recognition of current money rates. Similarly, if these companies*

*were no longer in the hands of the courts (and, as noted later, there is only a technical basis, and often not even such a basis, for continuing a number of them in the courts), many of them could refund their outstanding bonds at considerably lower rates of interest. It is desirable, until the necessary steps can be taken to remove them from the courts, to have such adjustment made, so as to eliminate any suggestion that unfair advantage accrues to any set of security holders by reason of artificial restrictions.* On the other hand, once such adjustment is made, it would seem only fair to clear up, on that basis, all arrears to the fullest extent permitted by the surplus funds.

The Bureau of Transport Economics and Statistics of the Interstate Commerce Commission has made a study of the contrast between interest charges payable by roads not in court hands and by roads in receivership or trusteeship. The fixed interest charges for the latter in 1944, as compared with 1940, increased 4.1 percent, and for the former decreased 12.5 percent (Monthly Comment on Transportation Statistics, March 7, 1945, p. 5). *It does not seem appropriate that in payments received and to be received, roads in the hands of the courts should be subjected to abnormal interest burdens, paying higher interest than is paid by other roads.*

While, of course, it is not suggested that any of the parties have intended to bring about such a result, it is nevertheless true that in its nature the result is akin to one of the most widely criticized features of the small-loan business of earlier days—the borrower who is in distress is made to overpay; *is, in effect, gouged. The artificial restraint on carriers subject to section 77 procedure, which was evolved for conditions far different from those now prevailing, should no longer be permitted to effect such unsound and unjustified disadvantage and damage to those companies.*

Companies which have any financial problems to solve could advance the solution of their difficulties by reducing their interest rates. The public in general will be benefited,

as was indicated by the president of the American Short Line Railroad Association at the hearings on S. 1253, as follows:

> As a help in meeting such a situation we are sure that a reduction in the cost for debt—in other words, the cost of debt service—could in many cases serve a very useful purpose, and entirely in the public interest, without unfairness to a minority (pp. 121-122).

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Yet, the interests of the railroads in the custody of the courts, and in the interests of the public as well, have been retarded, not advanced. The companies which would be most benefited by reduction of their interest rates are the very companies which are being prevented from securing a reduction.

*In all such matters, the need is apparent for an advance in financial techniques comparable to the great advance made in railroad operating techniques.* The former have not kept pace with the latter; there is considerable question whether there have been more than mere stirrings or beginnings of improvement in dealing with financial problems as required by sound business considerations. An example is presented in data furnished by the Interstate Commerce Commission in response to this committee's request. The example relates to the Chicago & North Western Railway Co. It was reorganized in June 1944. Reorganization obviously offered an opportunity for adjusting interest rates to current and oncoming interest levels. Some $54,000,000 of reorganization bonds were issued in July 1944, bearing *interest rates of 4 percent. Within a few months* the directors of the reorganized company took the necessary steps to bring about a refunding of those bonds, by a new *issue at 3 per cent*—a saving of over half a million dollars in interest charges per year (ICC table III). But meantime the railroad had to pay the extra amount of interest, and the charges for bankers' and distributors'

commissions and profits had to come out of the pocketbooks of the railroad company and investors.

The financial staffs of the Government agencies, railroad companies, committees, and other groups interested in the general problem possess the ability to bring to bear on this problem the same resourcefulness which engineering and similar experts and the operating managements and employees of the railroads have used in the operation of

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the transportation plans. Indeed, the financial problems are much simpler. *One may be confident that once the experts and interested parties are permitted to keep up, in financial developments, with the practical men engaged in railroad operation, the roads and the Nation, as well as the investors themselves, will reap substantial benefits.*

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The following data, dealing with eight major railroads in the custody of the bankruptcy courts, all but one still there, are taken from the elaborate tables prepared by the Interstate Commerce Commission.

**For period from Jan. 1, 1941, to June 30, 1945—average per year**

| Name of railroad company | Number of times average annual interest charges were earned* | Dollars earned per share of stock | |
|---|---|---|---|
| | | Preferred stock | Common stock |
| • • • • • | | | |
| St. Louis-San Francisco | 1.99 | 67.04 | 34.53 |

* The accounting rules of the Commission provide for the deduction of all taxes before considering the amount earned and available for payment of interest. In computing the number of times the annual interest or fixed charges were earned, financial manuals consider earnings before deduction of Federal income and excess-profits taxes, as well as after such deductions. The Commission has stated that net income before such tax deduction indicates certain earning power (annual report, 1944, pp. 7-8). The comparison in this and later tables computes times earned on the same basis for all companies.

Source: ICC, table VI C 1.

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The net income figures for 1945 will not be comparable with those for prior years. A very large amount of amortization, in excess of normal depreciation rates, has been deducted as an operating expense, in order to obtain benefits under the tax law. Most of this deduction represents a tax saving of 85½ percent of the amount deducted. The total deducted by way of amortization probably runs into hundreds of millions of dollars.

Part of this sum may be deducted as an expense in preceding years, necessitating a revision of the back figures of net income for those years as well.

The total cost of wartime facilities certified, so as to be amortizable under the tax law, is believed to be about one and one half billion dollars. If depreciated at the normal rate, say, 3.41 percent—a figure mentioned earlier in this report—the amount of depreciation chargeable annually as an operating expense would be about $51,100,000. The actual figure would be somewhat less, since depreciation of roadways and structures is not charged as an operating expense, and part, though a smaller part, of the facilities under discussion were roadway and structures. Whatever the precise amount, it is far less than the amount of amortization actually deducted as an operating expense for 1945 and two or more preceding years. The excess constitutes an arbitrary understatement of the earnings of those years.

On the other hand, the book figures for net income of postwar years will be higher to the extent that depreciation, otherwise chargeable as an expense, will not be charged on those installations for the many remaining years of their life.

### YEARS SUBSEQUENT TO 1945

In discussing business of the years subsequent of 1945, it is possible to make estimates of their probable earnings or to limit discussion principally to those facts which

are in the realm of certainty rather than in the realm of forecast. We shall limit our own discussion primarily to known facts and certainties with respect to the business of the several years following 1945.

(1) One established fact is that large bodies of troops, and large quantities of surplus goods released by the War and Navy Departments and of war material will have to be transported by our railroads.

As the Commission reported on November 2, 1945:

> * * * the cessation of hostilities has not brought strictly war demands to an end (annual report for 1945, p. 1).

(2) Another established fact is that the period of reconversion has already been under way for some months and that there is a large pent-up demand for civilian goods both on the part of returning members of the armed forces and on the part of the civilian population.

In the 1945 edition of A Yearbook of Railroad Information issued by the Western Railways and by the Eastern Railroad Presidents Conference, this subject is discussed as follows:

> World War II has ended. War production has been cut back or terminated, but large quantities of war materials in both theaters will be returned to the United States and transported by rail to arsenals and points of disposal. So long as large military forces remain in the European and Pacific areas, there will be a heavy movement of supplies and military personnel in both directions. Occupational forces also will require food and supplies. China's needs probably will be substantial and there will be continued heavy relief

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> shipments to the devastated countries in both theaters of war. Demobilization, at the rate of 500,000 persons a month, will demand considerable rail transportation.
>
> Unlike other industries, the railroads have no re-

conversion problem. Their plant in war is the same as in peace. During the war, the railroad plant was able to handle both military and civilian traffic. With the decline in war traffic it is ready to move the increase in traffic that will result from the resumption of civilian production (p. 1).

(3) A third known fact of considerable importance is provided by the carry-back provisions of the tax laws. These constitute in effect a guaranty of minimum normal earnings for the railroads for 1946.

On the subject of carry-backs and carry-overs under the tax law, the Bureau of Transport Economics and Statistics of the Interstate Commerce Commission made some valuable comments in its June 5, 1944, Monthly Comment on Transportation Statistics. The Bureau said, in part:

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Excess-profits taxes of class I line-haul railways, year ended Dec. 31, 1944

| Region and railway | Amount |
|---|---|
| * * * * * | |
| St. Louis-San Francisco* | $9,829,000 |

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While under the restraints and disabilities inherent in control by bankruptcy courts, these railroad systems have abundantly demonstrated their solvency. *They have overcome their financial difficulties to the point where the facts of solvency are opposed to the forms of insolvency.*

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UNPAID INTEREST CHARGES

There was some discussion at the hearings on the question whether a court has the power to discharge a company from section 77 proceedings under such circumstances. The counsel for the savings banks confirmed the chairman's opinion, as follows:

* Report of trustee or trustees.

> **Mr. Oliver.** Mr. Chairman, you are exactly right in saying that the courts have the inherent right to dismiss proceedings, and Commissioner Mahaffie tells me that that has been done in one case of a small railroad (hearings, p 76).

Reference to one such case was made in the Review of Railway Operations in 1944 issued by the Bureau of Railway Economics of the Association of American Railroads (p. 26). The association's report states:

> * * * the court discharged the debtor company from trusteeship on a showing that its improved financial condition made unnecessary the continuation of such proceedings (p. 2).

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*Some companies still in the hands of the courts are not presently able to pay their past-due interest but could have done so if their finances had been ordered in the same manner as if they had not been under court control in recent years. As a result of the action of the courts, and of the receivers and trustees appointed by them, funds which could have been used to pay past-due interest or to retire principal obligations were employed for surplus maintenance, or to purchase equipment for cash, or otherwise for purposes which were in effect the substitutions for paying off part of all the overdue interest.*

*In considering whether railroads which are in the hands of the Federal bankruptcy courts are now solvent, one assumes that the bankruptcy courts should have been desirous of so handling the affairs of these railroads as to overcome any condition of bankruptcy and to restore them to a condition of solvency; and it is assumed that to achieve this desirable end, the bankruptcy courts should have desired to conduct the affairs of the railroads as effectively as the railroad companies themselves would have done if they, instead of the bankruptcy courts, had been in control of their properties during recent years.*

Following this customary practice of railroad companies, most of the important railroads whose properties are at present in the hands of the bankruptcy courts, if the companies had been in control of their own properties, would by this time have been able to *pay all interest they owe for any past years right up to date.* They would have been able to do even more than this. They would in addition a large surplus amount of cash which they could either keep in their treasuries or could have used to pay and retire their bond issues and pay for some of the additions and betterments without any new financing whatever. This surplus amount which they could have so used after paying all their interest right up to date aggregated, on December 31, 1944, for seven important railroads, six of them still in the control of the Federal bankruptcy courts, approximately $317,000,000; as of the present time the aggregate is far greater.

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If these railroad companies had been in charge of their own properties they could have *undoubtedly refunded some of their bond issues at lower interest rates.* Had this been done for the year 1944 alone, by a reduction in interest rates to the lower level rate (the average interest rate on bonds floated from January 1, 1944, to June 30, 1945), the surplus amount after paying all interest charges up to date would have been $24,000,000 more or a total of $341,000,000. The amount in the cash saving of each of the above roads for 1 year alone would have been as follows:

* * * * *

St. Louis-San Francisco..... $3,094,386

Source: ICC table VI-C-8.

The ability of companies now in section 77 proceedings to pay all their overdue interest, if they had been allowed to follow the usual procedure of railroad companies which are in charge of their own properties, may be further studied by comparing the amount of matured unpaid interest as of December 31, 1944, with four other items which appear in the data furnished to this committee by the Inter-

state Commerce Commission. Those items show the amounts expended by the courts out of the funds of the railroad companies above listed, for additions and betterments during the period of the bankruptcy proceedings, the amounts similarly paid by the courts to reduce the long-term debt of the companies, the increase in the net current assets of the companies during the bankruptcy proceedings, and the postwar refund of excess-profits taxes payable to these companies as of December 31, 1944. The aggregate of these four sums exceeds the total amount of matured unpaid interest, as of December 31, 1944, by 63 percent.

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(In millions of dollars)

* * * * *

St. Louis-San Francisco:

| | |
|---|---|
| Matured unpaid interest at Dec. 31, 1944 | 96 |
| Amounts expended by the courts during the bankruptcy proceedings to Dec. 31, 1944 | 54 |
| Decrease in long-term debt during bankruptcy to Dec. 31, 1944 | 34 |
| Net current assets as of Dec. 31, 1944, in excess of net current assets at close of year preceding bankruptcy | 24 |
| Postwar refund of excess-profits taxes as of Dec. 31, 1944 | .... |
| Total of preceding 4 items | 112 |

Source: ICC, tables VII and VIII.

Even if the companies in section 77 proceedings would not have been able to pay all matured interest, their situation is nevertheless so good that it calls for a business rather than a court solution. If they were not now in court hands, it is unlikely that their present condition would lead their managements or their creditors to go to court for receivership or section 77 proceedings. Their affairs are in good shape, their past-due interest is, relatively speaking, sufficiently within the range of reasonable arrangement, and their present surplus and prospects for surplus in the next few years available to meet the remainder of the overdue interest are sufficiently good. Furthermore, the very fact, above noted, that bondholders of such companies have been receiving interest at rates fixed years ago instead of at the much lower level which the current money market

calls for, would, if taken into consideration, help considerably in solving the present financial problems of those roads by ordinary business adjustments rather than by court proceedings. In the case of such companies, it is fair to say that their insolvency is what might be called of a technical nature rather than genuine insolvency.

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The following figures, furnished by the Commission, demonstrate that in the case of seven major companies the net current assets (the excess of current assets over current liabilities) at the end of 1944 were 64 percent of the interest in default at that time:

(In millions of dollars)

* * * * *

St. Louis-San Francisco:

Matured unpaid interest at Dec. 31, 1944 ..... 96

Net current assets at Dec. 31, 1944 ..... 25

Source: ICC, table VII.

A comparison of the amount of matured unpaid interest with the cash on hand (including cash equivalents in the form of short-term Government paper and the like) is even more striking. The cash on hand at the end of 1944 exceeded the total amount of matured unpaid interest. The figures, again in millions of dollars, are as follows:

(In millions of dollars)

* * * * *

St. Louis-San Francisco:

Matured unpaid interest at Dec. 31, 1944 ..... 96

Cash and cash equivalents on hand at Dec. 31, 1944 ..... 40

Source: ICC, table VII.

The foregoing figures though impressive in themselves, are less striking than will be the figures (still to be gathered and published) as of the end of 1945. At the end of 1945 the net current assets, the cash on hand, and the income

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available for payment of interest will have greatly increased by reason of the profits of the year 1945. In addi-

tion, the net current assets and the cash on hand available for paying matured unpaid interest will have vastly increased by reason of the provisions of the tax law discussed elsewhere in this report. Those tax provisions will probably enable the railroad industry to have net current assets, as well as cash, greater than would otherwise have been the case, in the amount of $1,000,000,000, if not more. Mention has been made of the cash which will be retained by the companies under the amortization provisions of the tax laws. In addition, there is the tax-refund provision.

Many of the companies still in the hands of the courts (as well as many of the other railroad companies) received from the Federal Government at the end of 1945 large sums in the form of a refund of 10 percent excess-profits taxes paid to the United States Treasury during the present decade under section 210 of the Internal Revenue Code. Seven railroad systems in court custody paid, in 1944 (the year for which the separate figures for each company have been published), about 14 percent of the industry's $1,000,000,000 excess-profits taxes.

In brief, the only basic obstacle to the release from court, without any Commission proceedings or court reorganization, of various major railroads now in court control *is their unpaid, overdue interest;* the companies, *if they could have used their funds, could have paid all this overdue interest, but the courts and court-appointed trustees, having control of the companies' funds, used them in par for other purposes;* in any event, the earnings and the liquid resources of these companies, together with favorable money market conditions, would enable them to handle the problem of overdue interest in a businesslike way—if they were free from the section 77 *proceedings and procedures which in fact tie their hands.*

It is important to avoid the assumption that two quite different conditions are in fact one and the same. A *company's temporary inability to pay interest charges is not synonymous with worthlessness of the company's stock*

*which, by definition of the Interstate Commerce Commission, means that the stock is a nonearner).*

**SECTION 77 PROCEEDINGS**

Subsequent to the enactment of section 77 for railroad reorganization and the entrance of a number of systems into court custody under that statute, the theory was developed that companies in section 77 proceedings require drastic reorganization; contrast was made with companies in proceedings under the Chandler and McLaughlin Acts (ch. XV) which provide for mild reorganization. *Under the latter, stocks are not wiped out, whereas under the administration of section 77 they are usually wiped out. Thus, on the surface it might appear that companies in section 77 proceedings are likely to be insolvent companies, while those under chapter XV are solvent companies.*

*Testimony at the hearings on S. 1253 indicates that this is incorrect, and that the assumption is not justified that companies in section 77 proceedings are inherently weak and more in need of drastic reorganization than other companies.*

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In those years the statutory procedure was under section 77. Chapter XV was not enacted until 1939; thereafter major roads in need of statutory aid resorted to its procedure rather than to section 77. The need for such aid usually arose out of the fact that a company's bonds were about to mature, or would mature within a year or two, in a period when refunding was not available to it. This is what forced the Baltimore & Ohio to resort to chapter XV; testimony to this effect was given by the representative of the insurance companies (hearings on S. 1253, p 30). The maturity dates of companies' bonds, frequently responsible for decisions, both before and after 1939, to seek statutory aid, were fixed many years earlier, when the bonds were created. This coincidence, rather than in-

herent weakness, brought various major roads under section 77.

On this the following testimony was given by Mr. Purcell, vice president and general counsel of the Chesapeake & Ohio Railway:

> Most of the railroad bankruptcy reorganization proceedings have been caused by impending maturities of one or more bond issues during a period of depressed earnings when railroad credit was inadequate to permit of their refinancing. I look back to 1937 when the Nickel Plate Road was confronted with maturities of its Lake Erie & Western first mortgage bonds and Nickel Plate first mortgage bonds. You will recall that 1937 was a good year for railroad earnings. Fortunately, Nickel Plate was able to refinance. Had these bonds matured in 1938, a year later when railroad earnings were at a low ebb, Nickel Plate would surely have gone into bankruptcy. Certainly its common stock, probably its preferred stock, and possibly its outstanding unsecured notes would have been eliminated from any participation in a bankruptcy reorganization plan. Yet today the common is selling at more than 50, the preferred at 130, and the unsecured notes have been paid in full. What a vast difference resulted from the pure coincidence that those who decades ago caused the issuance of these bonds selected a maturity date in 1937 rather than in 1938.
>
> * * * *
>
> Similarly, we can all thank our lucky stars that the Pere Marquette, about two-thirds of whose common stock is owned by Chesapeake & Ohio, was not confronted with maturities during the thirties when its then outstanding high-interest bonds were selling at very substantial discounts.
>
> * * * *
>
> We look back today and are extremely thankful that those particular bonds, by the rarest coincidence,

came due in 1937, because the Nickel Plate's credit in 1936 and prior years, and in 1938 and subsequent years, was not such as would have made it possible to refinance those obligations in any year during the thirties other than 1937.

• • • •

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So that the Nickel Plate was saved from bankruptcy by the mere happenstance that someone, many decades before, who had created that bond issue, caused it to come due in 1937.

The misconception that the roads under section 77 procedure need that procedure, and in this respect are unlike those which have had the benefit of the milder procedure of chapter XV, may be studied in the light of data furnished to this committee by the Interstate Commerce Commission. These data dispose conclusively of the view that the former roads are essentially weaker than the latter or than their financial structures are fatally weak.

We shall consider first the more important of these two criteria, the ability of the roads in section 77 procedure to earn their interest charges, as compared with those which have proceeded under chapter XV. *The number of times that the annual interest charges are earned is a test not only of the solvency of a railroad, but of the quality of*

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*its bonds;* State laws apply this test to make sure that only safe railroad bonds are purchased by insurance companies, savings banks, and trustees for minors and others. In the testimony before this committee, a vice president of the Metropolitan Life Insurance Co., speaking in another connection, used this test to indicate the inherent soundness of the bonds of a temporarily distressed railroad company (hearings, p. 30).

The data furnished by the Commission at the request

of this committee take a period of 5½ years, January 1, 1940, to June 30, 1945. In that period, the net earnings before interest and Federal income and excess-profits taxes were more than enough to pay the interest and taxes of those years, both in the case of roads under section 77 and those under chapter XV; in fact, the interest charges for many more years than those 5½ years could have been paid out of those earnings. The number of times average annual interest charges were earned per year during those 5½ years by roads which have proceeded under chapter XV appears in the following table:

| | |
|---|---|
| Baltimore & Ohio | 2.19 |
| Boston & Maine | 2.28 |
| Colorado & Southern | 1.66 |
| The Delaware & Hudson | 2.43 |
| Lehigh Valley | 1.95 |

The comparable figures for major roads under section 77 proceedings are:

| | |
|---|---|
| Chicago, Milwaukee, St. Paul & Pacific | 1.83 |
| Chicago, Rock Island & Pacific | 3.21 |
| Denver & Rio Grande Western | 2.16 |
| Gulf Coast Lines (5 years only)* | 3.90 |
| Missouri Pacific | 2.79 |
| New York, New Haven & Hartford | 2.64 |
| St. Louis-San Francisco (5 years only)* | 1.86 |
| St. Louis-Southwestern Railway System | 6.98 |

Source: ICC table VI-C-1.

The average for the latter companies is 3.66, for the former it is 2.52. Thus, both when compared individually and collectively with the roads under chapter XV procedure, those which went into reorganization under section 77 prior to the enactment of chapter XV show up favorably;

*Omits first half of 1945.

collectively, they make a 68 percent better showing, on this all important test.

The data furnished by the Commission, of earnings per share during this same 5½-year period, are as follows:

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The comparable figures for major companies under section 77 procedure follow:

Earnings per share

* * * * *

St. Louis-San Francisco System (5 years only):*

| | |
|---|---|
| Preferred stock | $67.70 |
| Common stock | 37.27 |

Source: ICC table VI-C-1.

Excess profits taxes in 1944—per share of common stock

* * * * *

St. Louis-San Francisco System:

| | |
|---|---|
| Excess-profits tax, per share | $16.07 |

Source: ICC table VI-C-1; Monthly Comment, March 7, 1945, p. 3.

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The earnings per share of common stock are here given.

In the following list, three of the companies have already been reorganized under section 77; the figures are on the basis, not of the new capitalization, but of the capitalization prior to reorganization, and show the earnings on the shares wiped out under the reorganization plans.

Earnings per share of common stock of major railroads, 1941-44

(1) In Section 77 Proceedings

* * * * *

| | |
|---|---|
| St. Louis-San Francisco System | $37.27 |

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These figures may be considered on various bases—company by company, or average of the first 10 compared with the average of the second 10, or geographically.

Taking the averages, the section 77 roads show an av-

*Omits first half of 1945.

erage of $59.09 per share, the roads not in any court proceeding show an average of $54.70 per share.

On a geographical basis, we may take the three sections in which major roads under section 77 proceedings operate—northwest, southwest, and east and middle west.

These comparisons are important with respect to the problem raised by forecasts which decree that companies are insolvent, and that their stock is worthless. The question is not whether the stocks of railroads in section 77 proceedings are worth less than at the time when they were created, or are worth less than the stock of sound companies which are not in any court or Commission reorganization proceeding, except as a comparison highlights the essential solvency of the former companies and that their shares have earning power and value. When a Government decree wipes out the shares of stock of companies in

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section 77 proceedings, the decree is not that the shares are worth less than those of other companies, but that they are utterly worthless.

Comparison between the two groups of roads above listed, those in section 77 and those which are not in any reorganization, may also be made with respect to the excess profits they paid per share of common stock.

The comparison is even more revealing when each group is taken as a whole. For the 10 roads not in reorganization listed above, the average of excess-profits taxes accrued for 1944 was $23.31 per share of common stock. For the 10 roads in section 77 proceedings, the average was $34.35 per share of common stock. The roads in the hands of the courts thus accrued an average of 46 percent more excess-profits taxes per share of common stock than the comparable roads not in court hands.

The share of the section 77 railroads above listed compare favorably with the shares of the strong roads not in court proceedings both as to net earnings per share

after payment of taxes and deduction of all charges, and as to earnings per share set aside for excess-profits taxes.

The figures on excess-profits taxes per share of common stock have a special bearing on the question whether they are likely to have earnings in later years. As the Commission reported to Congress in 1944, "*the net income before deduction of income and profits taxes deserves attention as indicating the earning power of a railroad with the existing rates, fares, expenses, and traffic volume*" (pp. 7-8). Since income taxes have not been greatly reduced, and excess-profits taxes have been eliminated, it may be useful to limit a study of the per-share earnings for 1944 to consideration of the net income actually earned, and the excess-profits taxes per share. The figures for the major roads in the section 77 groups follow:

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1944 earnings per share of common stock

* * * * *

St. Louis-San Francisco System:

| | |
|---|---|
| Net earnings per share | $ 5.21 |
| Excess-profits taxes per share | 16.07 |
| Aggregate of earnings set aside for excess-profits taxes, and net income per share | 21.28 |

Source: ICC table VI-C-1; Monthly Comment, June 6, 1945, p. 6.

These figures are large; the earnings of the companies would have to drop to a very low point, and would have to stay that low, year in and year out, before one could say that the common shares of these companies can have no earnings at all in future years.

The data presented above deal only with the common stocks. Even if there were a certainty that they could earn nothing in the future, there would still be the question whether the preferred shares could have no earnings in the future; obviously, unless it can be demonstrated that the preferred stock will have no earnings, it may not be assumed that the companies are insolvent. Nine of the ten companies in the section 77 list above set out had preferred

stock outstanding, and made large earnings per share of preferred.

The comparisons above presented, with roads which are not in reorganization proceedings, may be amplified in one important particular. Those roads paid dividends in a number of instances for each year of this decade, in other cases for part of the period. Dividends were not paid during the period on the stocks of the roads in section 77 proceedings.

This does not indicate that the one class of roads is solvent and the other is insolvent, or that the shares of the one have value, and the shares of the other are valueless. In chapter XV proceedings, where the stock is saved and is regarded as valuable and the companies are regarded as solvent, limitations are placed on the payment of dividends.

*Indeed, the fact that for a period of time dividends were not paid only makes the assets of the companies larger, and their shares more valuable.*

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**ADMINISTRATION OF SECTION 77 PROCEEDINGS BY THE COMMISSION**

With exceptions relating to a very small proportion of the affected railroad stocks, *most of the plans of reorganization issued by the Interstate Commerce Commission in major cases arising under section 77 proceedings*

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*have treated the railroad systems under that section as insolvent. The plans have proposed that the preferred and common stocks of the companies be wiped out, on the ground that the companies cannot earn enough in the future to provide any yield or income on the stocks.*

The issue which the Commission decided in these cases was not whether there are earnings on the stocks of these railroads at the present time; the decisions, as will appear

shortly, *were made in earlier years.* If the issue were, whether there *are present earnings,* the answer would be obvious—there are big earnings on stocks—i. e., these stocks now have a value—i. e., *the railroads are not insolvent.*

The issue the Commission considered in these cases was whether the railroads would in the future earn anything on their present stocks. That, in the Commission's opinion, was its duty under section 77—to fix, for the companies under that section, a new capitalization based *upon its estimate of the future earnings of those companies.*

The performance of such a duty confronted the Commission with a dilemma, which makes clear the injustice to any agency charged with such a duty. On the one hand, if estimates of future earnings for purposes of new capitalization must be made, it is convenient to incline to the conservative if not the ultraconservative side; it is only natural to err in the direction of underestimating future good news about earnings, rather than the opposite. On the other hand, there is much to be said for the investors who urge that their property should not be foreclosed, that estimates made in 1939 and 1940 that the companies will not be able to earn anything on their stock have *already been shown to be unduly low,* and that in any event it is dangerous for anyone, particularly for a Government agency, to *destroy the property and investments of investors simply because the Government, no matter how well intentioned, estimates that at some time in the future there may be no income on those investments;* the stockholders ask why their securities, which are now, *and for* some *years have been, big money makers, should be now destroyed by Government fiat as presently worthless because a Government agency estimates that at some time in the future these securities will not be money makers.*

The nature of such forecasting is indicated in one of the Commission's decisions less than a year ago, when it said: "Any estimate of future traffic and earnings is, of necessity, speculative" (*Baltimore & Ohio Railroad Debt Adjustment,* 261 I. C. 51, 81).

What the Interstate Commerce Commission has felt that it does in making the estimates which are the foundation of its orders to wipe out stockholders was recently explained by Commissioner Porter, the chairman of its Finance Division, in testifying on H. R. 4779. The process is one, to quote his testimony, of "*making intelligent guesses. For this purpose, we studied the past history that was before us, we had the testimony of men who were regarded as in a position to make the most intelligent guess as to what the future might hold. And starting from that complete record up to the minute that it was submitted to us, we tried to make up our minds as best we could on that*" (hearings, December 18, 1945.) The Commissioner emphasized that the Commission looked to past years, and

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weighed in addition the testimony of men who were regarded as experts in making their prediction as to what the future might hold.

At the same time that the Commission recognized the impossibility of making a forecast, it believed itself compelled, under section 77, to make forecasts, and it was at that very time engaged in proceedings to arrive at forecasts. Its forecasts were made in all important cases in 1939 and 1940, as indicated by Commissioner Mahaffie to the committee considering H. R. 4779. *In some of the cases the plans were later revised, but the capitalization proposed*

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*by the Commission in* 1939 *and* 1940 *was not changed in most of the larger cases, and if changed in any of them, the change was minor.* The Commission's estimates of the long future, on which its proposals of capitalization were based were, so far as based on actual known earnings, made in the light of earnings to the end of 1937, and in a few cases to the end of 1938 or possibly after looking at preliminary figures for earnings in the first few months of

1939; substantially speaking, when it fixed the capitalization in the larger cases, it had before it the actual earnings up to the close of 1938—*the time when it frankly advised Congress of the impossibility of forecasting for the long future.*

*The forecasts made in those years, with the resultant proposals to eliminate 2½ billion dollars of securities, and to decree which security holders should be deprived of their securities, could not, of course, have the benefit of knowledge of fundamental changes of the near future.* The hearings on S. 1253 treated of this fact, as follows:

> The Chairman. Let me ask you this: Of course, when the Interstate Commerce Commission set forth their plans, they did not contemplate, or did not think these railroads were going to have this windfall to them on account of the war.
>
> Mr. Hagerty. That is right.
>
> • • • •
>
> Mr. Hagerty. The conditions were quite different when the Interstate Commerce Commission approved these plans * * * (hearings, pp. 34, 35).

In responsible quarters other than the Commission the same difficulty of making such forecasts has been experienced. Thus, during the war period pessimism about the future earnings of the railroads was based on various assumptions about the future. It was assumed that the railroads would in the future be subjected to a great increase in taxes; this expression was made at a time when the railroads were subject to 95 per cent excess-profits tax, the highest in their history. In the very year when such a future setback of their net income was being envisioned, 47 percent of the total tax bill of the railroads was due to the excess-profits tax—now eliminated; 21 percent of their total tax bill was due to the Federal income tax—now reduced in rate. In the following year these two Federal taxes were responsible for more than 70 percent of the railroad industry's total tax bill. A considerable por-

tion of the balance of their taxes fluctuates, as does the income tax, with the volume of their business, so that the larger the amount of such taxes paid by the railroads, the larger their net income (Statistics of Railways of Class I, calendar years 1929 and 1936 to 1945, Statistical Summary No. 29, prepared by Association of American Railroads, October 1945, at sheet 11).

Pessimism, similarly arising out of the inherent difficulty of prophesying, was based, in *quarters outside the Commission, on the assumption that the years after World War II would resemble those immediately after World War I.* In the actual event, when World War II came to an end, *it was found that the assumption earlier made was the exact contrary of the facts—the physical and financial condition of the railroads today is extraordinarily good, compared with their extraordinarily bad condition in 1918 and for some tme thereafter.*

Doubts about the future have also been based on the assumption that there would be a great increase in operating costs—*though improvements and constantly increasing efficiency now point in the opposite direction.*

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A fourth example may be mentioned. It has been assumed that reduced interest charges in the future support pessimistic prophecies about the future earnings of roads whose fixed charges are decreased. Those who make that assumption state that the less the interest charges, the less the deductions from gross revenue, for income-tax purposes, and thus the larger the income tax paid. Such forecasting overlooks the fact that net income increases as interest charges decrease, and would regard one of the greatest blessings that the industry can look forward to, as a disadvantage.

In short, others who have undertaken to forecast in this field have had the same experience as the Commission has had, in discharging the duty of forecasting which it

believes has been imposed on it by Congress. This duty, as demonstrated by the experience of others besides the Commission, is one which should not be imposed on a *Government agency, when the inevitable consequence of pessimistic forecasts is the destruction of existing property rights.*

The Commission, in its forecasts, sought to be conservative (*Western Pacific Railroad Company Reorganization,* 230 I. C. C. 61, 87). It is, of course, conservative to forecast one's own future income pessimistically rather than optimistically, when contemplating one's future expenditures for, say, luxuries. But there would appear to be some justification for the view of junior security holders that, if the consequence of *one's forecast is to wipe out another person's investments, the forecast which is conservative in the eyes of the forecaster is radical in the eyes of the investor—more than radical; it is destructive of his property rights.*

The soundness of the Commission's warning to Congress about the impossibility of forecasting future earnings was demonstrated every year after it had issued its conservative forecasts that the companies would not earn anything on their stock, with the consequence that the stocks of those companies must be destroyed. Since the completion of its forecasts and orders to wipe out the stocks of the major railroads in section 77, every one of those railroads has earned large sums on its stock every year (except two of the companies, which missed out in 1941 and only in that year).

The entire series of forecasts in nine major cases, with the conclusion that the stocks would have no earnings in the future and must be destroyed, was completed by 1941; most of the decisions were made in 1939 and 1940. The dates follow:

* * * * *

St. Louis-San Francisco..... July 6, 1940

Source: Hearings on H. R. 2857, p. 197.

The earnings on the stock of these companies, in the period after this series of forecasts was virtually completed (i. e., after 1940), were as follows (the figures were furnished by the Commission in response to the request of this committee):

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*Earnings on the stock (ordered by the Commission to be wiped out), Jan. 1, 1941 to June 30, 1945*

* * * * *

St. Louis-San Francisco.....$36,321,158

Source: ICC table VI-C-1.

These are only the amounts of the recorded income. The actual income was much larger. All but a small percentage of the cost of the wartime installations, though deducted (for tax purposes) as an expense, was in fact a capital addition to the property. The figures showing the total for the nine systems listed abve have not yet been compiled and published; a rough estimate would assign 15 percent of the total figure for the industry to those companies (they operated about that percentage of the raiload mileage; they paid that percentage of the industry's excess-profits taxes for 1944). On the basis of a total expenditure of the industry for such installations in the amount of 1½ billion dollars, the unreported earnings on the stock of the nine systems listed above, with respect to the single item of amortization, would be approximately $225,000,000.

The actual income on the stock of those companies for the years since the Commission's no-earnings forecasts must also take account of two other items—the refund of 10 percent of excess profits paid and any additions or betterments charged as operating expenses.

It is perhaps not far from the mark to figure that the actual *earnings on the stocks of the nine systems since*

*the Commission made its forecasts of no earnings on the stocks are about $750,000,000.*

These figures indicate that the valuations made some years ago *require revision, even if reorganizations are still to be based on valuations, and valuations on forecasts.* When three-quarters of a billion dollars are added to the assets, which prior to such addition, had been appraised at a specified amount, that amount must be increased accordingly. *Further, the very basis of the appraisal requires modification, since it was based on a forecast of no earnings on the stock, and business operations each year thereafter showed actual earnings on the stock.*

On the question of changes subsequent to the Commission's making of an appraisal of value, the chairman of this committee said at the hearings on S. 1253:

> The Chairman. It seems to me that, when conditions have changed to such an extent as I have indicated, that railroad should have and does have the inherent right to have those changed conditions recognized (hearings, p. 76).

However, doubt has been expressed whether the Interstate Commerce Commission has the authority under the statute to recall a plan of reorganization from the courts, after it has been certified to them by the Commission. *Doubt has been expressed whether the Commission may even make representations to the district court to*



*which a reorganization plan has been sent, stating that changed conditions require modification of the plan in the interest of justice. The Commission has resolved these doubts against the exercise of such power by it, and, deeming its authority strictly limited in this respect, has not made necessary revisions of plans, no matter how imperatively required in the interest of justice, unless and until the district courts have themselves found the plans to be*

*unfair or unsound or have for any other reason returned them to the Commission.*

Such limitations obviously result in large difficulties and injustices.

District and appellate courts should not be burdened with proceedings to consider the fairness and soundness of reorganization plans *which the administrative commission may already know to be out of date.* Furthermore, a plan which is already out of date may nevertheless *pass the scrutiny of the courts because of deference for the views of the administrative tribunal and out of ignorance of the fact that members or staff of the Commission realize that the plan pending in the courts is outmoded, and that its effectuation would constitute a disregard of important facts and of important considerations of justice.* This is apparently what happened in one railroad reorganization which was consummated in 1944, and another in 1945, with serious injustice to security holders who were wiped out and with unjust enrichment of other security holders; in each case a great increase in value of the securities had taken place between the time of the Commission's first conclusion as to capitalization in reorganization, and the time the district court finally approved that conclusion and put into effect; *these changes had demonstrated that the holders of the securities wiped out under the plans actually had a genuine and valuable interest in the railroad properties and were entitled to participate in the reorganizations; since this fact, ascertainable subsequent to the Commission's decision, was disregarded, security holders were unjustly subjected to forfeiture.*

If, however, the Commission should be called upon to revise its forecasts, it would be confronted by the same difficulties as before.

Prudence calls for recognition of the wisdom of Commissioner Miller's statement in one of the cases in which the Commission was discharging the duty imposed on it by Congress, the duty of making forecasts. The Commis-

sioner said: "We are not omniscient and cannot foresee the future" (*Chicago, Rock Island & Pacific Ry. Co. Reorganization,* 242 ICC 298 at 475).

The difficulty experienced by both the Commission and others who have either been obliged or have ventured to forecast for the long future, and the hazardous nature of pessimistic forecasts in particular, are present today in as full measure as before.

Any agency, governmental or nongovernmental, obliged to make an estimate of future earnings, must answer many questions which it is difficult to answer and on which, no matter how earnest and informed the person or agency may be, error cannot be eliminated. For example, to what extent has the higher earning rate of the years 1940-45 affected the estimate which should be made for the years thereafter? What will be the effect of the carry-back provisions of the present tax law? To what extent will future earnings be benefited, by reason of recent surplus maintenance, or by reason of current and recent underrecordings of earnings? What dollars estimate shall be placed on postwar consumer demands? What will be the effect of the

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elimination of excess-profits taxes? What will be the effect of the initial reduction just made in income-tax rates, and what is the likelihood of future reductions?

Above all, what will be the future level of business of the railroad industry? This is perhaps the most important question of all.

It is only natural that *forecasting should partake of the mood of the period in which it is undertaken. This is true, even in the case of the most expert and disinterested forecasting.* For example, it is interesting to compare the pessimistic forecasts made at the end of the last decade with the Commission's statement to Congress early in the same decade. In 1931, when the business depression had run for only 2 years, the Commission stated:

> * * * while the tide may be slow in turning, there is no more reason for thinking that business will not improve than there was in 1928 for thinking that depressions were a thing of the past and that the country had entered an era of permanent prosperity. Too much weight ought not to be attached, therefore, to the present discouragement of investors. When railroad earnings take a sharp turn upward, as in due time they will, railroad credit will also rise (annual report for 1931, p. 115).

Reference has already been made to the statement in the 1932 report of the Commission on the basis of which it would appear that the railroads could make as large a net income as in 1929 if their future volume of business should be as much as one-half of the volume for the year 1944.

An additional question confronting individuals or agencies which make estimates of the future earnings of railroads is discussed in the concurring opinion of United States Circuit Judge Phillips in *The Denver & Rio Grande Western R. R. Co. et al. v. Insurance Group Committee et al.*, on May 10, 1945, and in testimony received at hearings on H. R. 4779, on December 26, 1945. The opinion of the presiding judge, and the testimony on the bill, both raise the question of effect on railroad revenues of a high national income in the years ahead. As Commissioner Mahaffie wrote to the House Judiciary subcommittee on December 18, 1945, such a national income "undoubtedly has some relation to railroad revenues as a whole," though it cannot be conclusive with respect to the affairs of individual roads, other facts requiring consideration also. Judge Phillips called attention to the effect of a greatly increased postwar railroad traffic on the fortunes of the road with whose reorganization under section 77 the court of appeals was then dealing.

This new factor, together with other new factors which have come to the front in the last 4 or 5 years, after the Commission initially fixed its presently outstanding pro-

posals of capitalization, add even greater emphasis to the pronouncement of the Interstate Commerce Commission in its annual report to Congress in 1938. The Commission said:

> Every reasonable effort should be made to protect existing security holders, but not where their securities have clearly lost all value (p. 21).

*It is obviously difficult to reach the conclusion that junior securities of the railroads have clearly lost all value.*

*To wipe them out is in effect to say, at a time when these stocks are earning as much as the strongest railroads earned in the most prosperous years, these stocks must be wiped out because a Government agency, having*

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*made the most intelligent guess it could, has guessed that they may not be able to earn anything at any time in the future.*

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**EFFECT OF COURT ADMINISTRATION ON THE FINANCIAL POSITION OF RAILROADS UNDER SECTION 77**

An additional difficulty arises out of the fact that for many policy purposes, court-appointed trustees have replaced the managements of companies which are in section 77 proceedings. In important respects the trustees and the courts decide, by their action or inaction, the extent of the earning power of those companies and their stocks. In particular, the courts and the trustees they appointed decide whether to cut and how much to cut, the interest charges for which the companies are obligated; *the managements of the companies are deprived of this crucial power.* The subject calls for mention of the provision of section 77 making mandatory the substitution of trustees for managements.

Section 77 was amended in 1935. One of the amendments required Federal courts to appoint trustees of the

railroad properties of companies under section 77. The purpose of this provision was to have independent investigation and correction of any abuses prior to the court proceeding (H. Rep. No. 1283, 74th Cong., 1st sess., p. 4). Such investigations have long since been completed. But the statutory provision has continued. It has ousted the managements of the roads up to the present time. *In the last few years, and now, active and aggressive management was and is critically needed in order to enable the roads to make the fullest use of present-day opportunities to reform their financial structures, reduce their indebted-*

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*ness, and reduce the interest rates of their bonds and their total interest charges.* The Interstate Commerce Commission has for some years been urging the railroads to take such action. Railroads not under section 77 have done so; railroads under section 77 have done so to a very limited extent, *and their managements have been unable to move at all in securing the very results which the Commission has wisely and repeatedly urged.*

A third difficulty is due to the fact that the sights of the courts and trustees, as well as of some of the *bondholder groups not injured by the wiping out of the stock, were directed to reorganizations having such consequences. Eyes were closed to the abundant opportunities of correcting the financial structures on a business basis, without such drastic consequences. Business conditions made possible the accomplishment, by mild procedures, of the major objective of drastic reorganizations under section 77—the reduction of interest charges. Business conditions also made possible the accomplishment, by resort to business methods, of the secondary objective of drastic 77 reorganizations—the reduction of outstanding capitalization. But section 77, the control of the properties by trustees, and the concentration on drastic reorganizations to the exclusion of solutions made available by business developments have all stood in the way.*

On the subject of business conditions which have laid the foundation for a reduction of interest charges, the Commission has frequently spoken and advised action by the railroads. It will be sufficient to quote briefly from four recent decisions by the Commission, calling attention to the developments in the money market. It noted, on July 6, 1945, "the favorable market conditions now existing" (*L. & N. R. R. Co. Bonds,* F. D. 14959). It authorized refundings at reduced interest rates because the railroads thereby effected "a saving in interest by taking advantage of the present low interest rates" (*Arkansas & Memphis Bridge & Terminal Co. Bonds,* F. D. 14918, decided July 30, 1945). It repeated its references to "present favorable market conditions" (e. g., *Union Pacific Railroad Co. Bonds,* F. D. 15035, October 5, 1945; *Lehigh & New England Railroad Co. Bonds,* F. D. 15071, October 31, 1945).

A perusal of recent decisions of the Commission shows that a large number of railroads have taken advantage of those conditions to reduce interest rates and thus total interest charges. The reduction in total charges is, of course, due in part to lowered interest rates, and in part to reductions of debt. The Commission frequently calls attention to the substantial results achieved, in a business way, by taking advantage of present conditions. For example, in one of the cases noted above, the Commission described the success of one large road in reducing its annual interest charges, over a period of years, by 46 percent (*L. & N. Bonds,* F. D. 14959). Examples were discussed at the hearings on S. 1253; Great Northern, partly through retirement of debt and partly through reduction in interest rates, cut its interest charges more than one-half (hearings on S. 1253, p. 9).

Of course, the more powerful and strongest roads have been availing themselves of the opportunity at hand; by refunding operations they have reduced the interest they pay on substantial portions of their debt, *the reduction being in a number of cases as large as 1 percent or 1½*

*percent, and in some instances being even large, one case late in 1945 showing a reduction of more than 2½ percent.*

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*Rates have been reduced to 3 percent and even less (e. g., G. N. Ry. Bonds,* F. D. 15014, September 11, 1945; *No. Pac. Ry. Bonds,* F. D. 15028, September 19, 1945; *So. Pac. R. Bonds,* F. D. 15020, September 19, 1945; *T. & P. Ry. Bonds,* F. D. 14958, July 19, 1945; *Un. Pac. Bonds,* F. D. 15035, October 5, 1945; *Penn, Ohio & Detroit R. Bonds,* F. D. 15063, October 17, 1945; *Western Maryland Ry.,* F. D. 15080, October 24, 1945; *Terminal R. R. Association of St. Louis,* F. D. 15070, October 26, 1945; *N. Y. Connecting R.,* F. D. 15078, October 26, 1945; *Lehigh & N. Eng. R. R.,* F. D. 15071, October 31, 1945; *Maine Central R. R.,* F. D. 15127, December 14, 1945; *C. B. & Q.,* F. D. 15125, December 19, 1945).

Other companies, of small size and not to be classified in the group which can command the lowest rates in the money market, have been making comparable progress. For example, one small road was able to refund notes at a 2½-percent interest rate (*Wichita Falls & Southern R. R. Co. Notes,* F. D. 14954, July 11, 1945). Denver Union Stock Yards Co. refunded 3¾-percent obligations and issued an additional amount all at 3 percent, the entire transaction being effected with one of the large life-insurance companies (F. D. 15055, October 5, 1945). Texas City Terminal Railway refunded an obligation which carried 4-percent interest charges, with a 10-year installment note carrying interest charges of 2⅞ percent (F. D. 15135, December 18, 1945).

*Railroads which were in difficulties in the 1930's but escaped section 77 have already made great strides in the direction of reorganizing their financial affairs in this major respect.* For example, the Missouri-Kansas-Texas Railroad Co., one of the companies which, though in straits during the depression, avoided section 77 proceedings, has been able to benefit by the changed conditions of the money market. *This company has just effected a 2-year bank loan*

*at 1¾-percent interest, with the approval of the ICC, and is going to use the borrowed funds to retire debt on which it had been paying much higher interest rates* (*Missouri-Kansas-Texas Ry. Co. Bonds*, F. D. 9660, decided by ICC December 27, 1945).

Nickel Plate, according to Mr. Purcell, vice president and general counsel of Chesapeake & Ohio Railway, was able to cut the debt and interest charges, since it was not under section 77 procedure. He said:

> The Nickel Plate, having escaped bankruptcy, was able to devote its funds to retirement of its indebtedness, and just as soon as earnings permitted, the Nickel Plate having somewhere in the neighborhood of 145 million of bonded indebtedness outstanding, set about to retire that indebtedness. And when it had brought the debt down to about $100 million through the application of excess earnings for the purpose, it was able to refinance its high interest obligations, and today it has two series of refunding mortgages outstanding, one carrying 3¾ percent and the other 3¼ percent (hearings on S. 1253, p. 81).

Similarly, the Interstate Commerce Commission noted in a recent report that Alleghany Corp., a holding company, had made excellent use of the opportunities afforded by money conditions of recent times. First, it reduced the interest rate on its indebtedness from 5 percent to 3¼ percent; early in 1945 it arranged a large bank loan for a period of a number of years at an interest rate of 2½ percent. Each borrowing at progressively lower rates, was used to retire obligations incurred at higher rates of interest (*Chesapeake & Ohio Railway Company Purchase*, 261 I. C. C. 239, 247).

*Even trustees appointed by the courts to control railroads in section 77 proceedings have participated in re-*



*funding arrangements which reduced the interest rates*

*paid by raidroads. This was done, not for the companies in their control in section 77 proceedings, but for companies controlled by those railroads.* Thus, one company owned by the Missouri Pacific, the St. Louis Southwestern and the Rock Island, reduced its interest rate on a bond issue from 5 percent to 2¾ percent, in a refunding operation; in the application to the Interstate Commerce Commission to authorize this refunding, the court-appointed trustees of the three railroads which jointly own the refunding company took part; the Commission was informed that this refunding was undertaken "in order to effect a saving in interest by taking advantage of the present low interest rates" (*Arkansas & Memphis Railway Bridge & Terminal Company Bonds,* F. D. 14918, July 30, 1945).

In another recent case, a large bond issue (over $40,000,000) was refunded, reducing the interest coupon from 4 percent for the bulk of it, and from 3⅜ percent for the remainder, to 2⅞ percent. The company which effected the refunding is owned by 15 railroads, including 5 which are in control of court-appointed trustees in section 77 proceedings—Missouri Pacific, St. Louis Southwestern, Rock Island, St. Louis-San Francisco, and Alton. The 15 proprietary railroads, 10 through their managements and 5 through court-appointed trustees, participated in the application to the Commission, and guaranteed the new bonds; each guaranteed one-sixteenth of the bond issue, except the trustees of the Missouri Pacific, who in its behalf guaranteed two-sixteenths (*Terminal Railroad Association of St. Louis Bonds,* F. D. 15070, Oct. 26, 1945).

In another case, a railroad company owned by the New Haven Railroad and the Pennsylvania Railroad refunded a bond issue of more than $25,000,000, reducing the interest coupon from 3½ percent to 2⅞ percent; the trustees of the New Haven, appointed by the court in section 77 proceedings, joined the Pennsylvania management in the case, and both guaranteed the new bond issue (*N. Y. Connecting Railroad Company Bonds,* F. D. 15078, Oct. 26, 1945). In another recent case, the reduction in interest

rates was effected, without a guaranty by the three proprietary roads, one of them the Missouri Pacific, controlled by court-appointed trustees (*Texas City Terminal Railway Notes*, F. D. 15135, Dec. 18, 1945).

With the significant exception of one group of railroads, the railroad industry has been making greater and greater use of the opportunity at hand in recent years. By September 30, 1942, the interest rate on over $1,000,000,000 of railroad debt had been cut more than 1 percent (Annual Report of I. C. C., p. 27). The progress since then has been large. New bonds issued in refunding operations at reduced rates of interest are likely to be the subject of further refundings at still lower rates of interest; bonds issued in such operations during the latter part of 1945 are already being prepared for further refunding, and the files of the Commission now contain official notice that this program is getting under way.

Every railroad which was in a position to do so has been benefited by the improved money market conditions. As the Interstate Commerce Commission reported to Congress in 1943, railroads are alive to the opportunity "to reduce the burden of fixed charges"; the opportunity to refund bond issues "at lower rates of interest" has already been taken advantage of by—

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> most railroads in a position to do. It is gratifying to report that more and more railroads in a position to do so are voluntarily reducing * * * the burden of fixed interest charges (annual report for 1945, p. 25).

*Which railroads are in a position to make use of this opportunity, and to give this gratification to all who are interested in the health of the railroad industry? The managements of those companies which had the good fortune to be free from heavy maturities in initial years or for other reasons were able to avoid the section 77 procedure have reduced their interest rates. Many companies which*

*were under section 77 equally possess every facility for making use of this boon—except that the section 77 proceedings tied their hands. These latter railroads have big cash surpluses, they are big earners of profits, they operate in an era in which other earners have reduced their interest rates to as low as 3 percent or less.* As the chairman of this committee stated at the hearings on S. 1253, *companies in section 77 proceedings have been prevented from getting "equality with other railroads" which have cut their interest rates* (hearings, p. 9). They could have worked out their own reorganizations with their creditors if their managements had been free to manage their properties and their financial affairs. *Instead, however, some of their creditors have enjoyed substantial windfalls by reason of the inability of the managements to proceed with aggressiveness and dispatch in reorganizing their financial affairs on a business basis, by business methods, and without resort to the assistance or initial participation of Government agencies. These creditors have been able to receive much higher interest rates than have been justified by money conditions of recent years and the present time.*

It is not alone while railroad properties have been in the control of the trustees under section 77 that the managements of such companies have been unable to make use of present-day money conditions. Even when the reorganization machinery of section 77 is used and companies are reorganized under that procedure, new bonds are created in the reorganization process, *and there is an opportunity to fix the interest rates of the new bonds at levels appropriate under present-day money conditions, this is not done.* Earlier in this report reference was made to the case of one railroad (the Chicago & North Western) in which some $54,000,000 of reorganization bonds were issued at an interest rate of 4 percent when 3 percent would have been far more appropriate. The result was that after the reorganization was completed, the management of the company had to go into the market and sustain the considerable expense, which was wholly unnecessary, of refunding at a 3-percent rate (ICC table III).

*So far as some of the creditors are concerned, the windfall they have been receiving at the expense of the companies that are under section 77 and at the expense of their stockholders is not deemed the only factor worthy of consideration on their part.* The representative of the savings bank and security owners stated in the hearings on S. 1253:

> * * * It seems to me it is better for us to take what the property can produce temporarily, over a period, than to go through this drastic reorganization procedure provided by section 77 (p. 71).

*Companies in section 77 proceedings have been at a disadvantage in reducing their debt, as well as their interest rates. Major companies in section 77 proceedings have, and for several years have had, abundant funds for*

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*retiring debt.* The Commission has urged all railroads to use their excess funds for such purposes. *The Commission has indicated that one method is by purchasing of outstanding bonds, on the bond market, at prices often below and even far below par, with large savings to the railroad companies* (ICC Annual Report to Congress for 1943, p. 29). *This opportunity was especially useful for companies in need of reorganization, since their bonds were particularly depressed in price.*

Striking proof of the value of the method urged by the Interstate Commerce Commission is to be found in the data it furnished at the request of this committee. *Three important railroads which achieved reorganization under the mild procedure of the Chandler and McLaughlin Acts have had marked success in buying their own bonds prior to maturity, at substantial discounts.*

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*Our committee asked for similar data with respect to a number of roads in section 77 and equity-receivership procedure. For each of the following 11 roads, the Com-*

*mission's answer under the heading "Amount of bonds purchased" was "None."*

*These roads were in a position to save far more than were the roads which went through the chapter XV procedure, and the roads which did not go into court or Commission reorganization at all. The bonds of the companies which were under section 77 or in equity receivership were selling at far lower prices than the bonds of the other companies; and, in addition, the bonds of the former carried a number of matured, unpaid interest coupons which would be included in the price paid;* for example, a company not undergoing court reorganization would buy for $485, as did the Baltimore & Ohio, simply a $1,000 bond, without any unpaid, matured coupons attached to it. But a road in section 77 proceedings would buy, for the purchase price, not only the $1,000 bond, but also a number of attached matured, unpaid coupons, which might amount to $250 or $500 more. Thus the saving for the roads in section 77 proceedings and in equity receiverships would be greater than in the case of the other roads, both because the market price was lower and because the purchase included matured, unpaid interest coupons.

In some instances the courts have ordered the use of surplus cash of railroad companies in their control to pay off entire bond issues, or to make part payment of bond issues, at 100 cents on the dollar. *The trustees did not use the surplus cash of the railroads to buy those bonds in the market at less than 100 cents on the dollar, or to call for tenders by bondholders. The result was that purchasers of the bonds at less than 100 cents on the dollar, at a time when the excess funds of the railroad companies enabled the trustees themselves to make such purchases at less than par, were able to turn in their bonds to the trustees shortly afterward at 100 cents on the dollar.* Several examples will serve to illustrate how the roads lost money in this way.

*In October 1942 the trustees of St. Louis-San Francisco Railway Co. petitioned the court which had appointed them, to authorize them to pay in full, at 100 cents on the dollar, mortgage bond issues on one of the divisions of this road (the Kansas City, Memphis & Birmingham Railroad Co. general and income bonds). The court gave the authority to pay about $6,500,000 of these bonds, and they were paid in November 1942 (ICC table VI-C-4 (1).* Previously, in *1941, the bonds were the subject of trading on the Boston Stock Exchange at prices ranging, for the general bonds, from a low of 80 to a high of 87½, and for the income bonds, from a low of 74 to a high of 85. In 1942, to July 1, the prices were a low of 83 and a high of 88 for the gen-*

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*eral bonds and a low of 18½ to a high of 85 for the income bonds* (Moody's Railroad Manual for 1942). *Purchasers who acquired these bonds in 1941 and 1942, when the railroad had sufficient money to enable the trustees to buy for it at those prices on the Boston Stock Exchange and in the bond market outside that exchange, were able in November 1942 to collect 100 cents on the dollar from the trustees. Neither the company nor its management had the power or liberty to use the funds of this railroad to buy the bonds on the market, and apparently the trustees appointed by the court did not think they were in a position to take such action.*

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VI-C-5). For each of the years 1941 to 1945, inclusive, data are presented with respect to bond issues of highest mortgage rank now outstanding in the amount of $10,000,000 or over, and listed on the New York Stock Exchange; figures were compiled showing the total of trading on that exchange in each of the issues for each year, and the high and low prices of each year (undeposited bonds and certifi-

cates of deposit for bonds are combined as one). Including over-the-counter sales, the volume was, of course, far greater than the figures here given.

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* * * * *

ST. LOUIS-SAN FRANCISCO Kansas City, Fort Scott & Memphis refunding 4-per-cent bonds of 1936

| | Excess-cash at end of year | Face or par amount sold on New York Stock Exchange | High price | Low price |
|---|---|---|---|---|
| 1941 | $10,959,727 | $5,251,000 | 49¼ | 32 |
| 1942 | 12,952,445 | 9,717,000 | 69¼ | 37½ |
| 1943 | 13,897,429 | 10,193,000 | 91 | 61 |
| 1944 | 15,454,650 | 5,291,000 | 90¾ | 71⅞ |
| 1945 | ..... | 5,412,000 | 93½ | 78 |

The prices at which purchasers bid up these bonds in 1945, and the volume of purchases at such prices, indicate that the opportunity is no longer available to the companies to purchase these bonds on the market or by call for tenders, with savings of the size available heretofore. It is evident that investors now regard these bonds as prime investments; there can be little or no doubt that bonds of this rank could be floated by the companies in the ordinary financial channels. These facts constitute a tribute to the soundness of the companies; ordinarily, as experts in this financial field testified in the hearings on S. 1253, *the credit of companies in section 77 proceedings is impaired, and the prices of their bonds are considerably below their true value* (pp. 70, 116).

*Though the earlier opportunity to purchase bonds of topmost rank at the large discounts obtainable in prior years has now been lost, the companies in section 77 proceedings can still reduce debt and effect substantial savings in so doing. Their second mortgage and similar bonds are still selling at less than par, even though the interest charges on these categories of bonds have been earned for a number of years—as already noted, the interest charges were earned two or more times per year, by many of the major companies, for the past 5 years.*

Investors will undoubtedly continue to purchase these bonds in large quantities, and at substantial discounts from their par or face amount; this is demonstrated by figures we here cite. *The question which remains is whether the companies will be permitted to avail themselves of this opportunity, or will be deprived, as heretofore, of the right to reduce their indebtedness and to correct their financial position, by this method.*

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| • • • • • St. Louis-San Francisco | Face amount of bonds outstanding | Face amount of bonds sold on New York Stock Exchange | High price | Low price |
|---|---|---|---|---|
| (1) Prior-lien 4-percent and 5-percent bonds of 1950.. | $117,448,597 | | | |
| 1941 | | $26,625,000 | 16½ | 8⅝ |
| 1942 | | 45,882,000 | 25⅛ | 10⅞ |
| 1943 | | 69,804,000 | 41½ | 18⅝ |
| 1944 | | 64,585,000 | 54 | 32¾ |
| 1945 | | 61,489,000 | 71½ | 48 |
| (2) Consolidated 4½-percent bonds of 1978 | 108,305,000 | | | |
| 1941 | | 33,328,000 | 16⅜ | 9½ |
| 1942 | | 46,426,000 | 23¼ | 11½ |
| 1943 | | 72,809,000 | 39⅜ | 19⅜ |
| 1944 | | 58,237,000 | 40¼ | 28¼ |
| 1945 | | 55,936,000 | 51⅛ | 36¼ |

Rarely, if ever, in the history of the railroad industry has there been so valuable a conjunction of circumstances—low prices for buying in a company's bonds and large amounts of cash available for such purchases. Rarely, if ever, has so invaluable an opportunity been lost, as it has been lost, year after year, to the disadvantage of railroad companies, helpless in *the section 77 strait-jacket which had been devised for other times and other needs.*

The trustees in control of their affairs have not, of course, had the same incentive as their managements and owners to use the opportunity so constantly at hand. While the trustees have listened to the views of interested security

holders, they have given a greater degree of deference to the spokesmen *for bond interests than to the spokesmen for the companies and thus of the industry.*

The same may be said of a comparable method of reducing debt by the expenditure of smaller amounts than the principal and accrued interest of bonds outstanding—a public call for tenders. This can be done during chapter XV proceedings and would be available during S. 1253 proceedings; it is also available to companies which, like the Nickel Plate, proceeded without assistance of statutory aids.

*Another method of reducing debt, that of paying principal and all unpaid coupons, is available under all the procedures, statutory and nonstatutory.* It has been used by court-appointed trustees in the section 77 proceedings; as noted earlier in this report, the use has been a hesitant and unduly limited one, with the consequent piling up, for years, of additional interest charges on bonds which could have been, but have not been, retired. This unnecessary burden on the companies and thus on the railroad industry was criticized at the hearings on S. 1253 (pp. 9, 13, 75, 103-104).

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The third obstacle earlier mentioned, the assumption that companies in section 77 proceedings cannot correct their affairs, in whole or in part, by using their cash prudently to reduce debt and cut interest rates, should of course be removed.

In the long run, it will be helpful if the finances of these companies can be restored promptly under mild procedure, in accordance with business methods, and on the basis of present-day money conditions and of the cash surpluses of the companies.

In order to enable the companies to proceed with the utmost dispatch in reducing their interest charges and their

outstanding debt, it is necessary to unshackle their managements.

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**CHANGES APPROPRIATE IN ADMINISTRATION OF RAILROADS IN HANDS OF COURTS**

(1) One of the most important changes which should be made is the discharge from trusteeship or receivership of those companies which are able to pay their overdue interest, without court reorganization of their financial structures. To this end the courts and their trustees and receivers should bend their efforts, as would a company not in the hands of the courts. The advantage would be one both for bondholders and stockholders. Bondholders who are now being offered reorganization securities and are being asked to agree to substantial changes in their contractual right to receive income on their bonds currently are entitled to retain those rights, with the exception of the change in the rate of interest which money conditions and the money market necessitate.

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(5) The administration of reorganization can range from the drastic to the mild. *It can be geared to changed conditions —and the changes in the affairs of companies still in the hands of the courts today present a very different reorganization problem from that in the 1930's.* In consequence, the very approach made to that problem in the years prior to the vast changes in the affairs of the companies during this decade *is today outmoded. The companies themselves, by playing a larger and indeed the leading role, can bring about just results for both creditors and stockholders.* For solving their financial problems, the companies possess opportunities they did not have until the last 5 years and today have in greater abundance than at any time in the abundant 1940's.

The opportunity to bring about reductions in interest rates is something new in their affairs; *it is a substitute for*

*drastic reorganization.* The possession of large funds to reduce debt, and thus to eliminate interest charges on the debt retired, and to provide the basis for still further reduction of the interest rates on the balance of the debt, is of course of inestimable importance. The reduction in debt and interest charges, the record of high earnings, the easing of financial difficulties, the conversion of what seemed in the 1930's to be a mountainous task into one that is now relatively simple of adjustment between creditors and stockholders—all these indicate *the desirability of substituting a business approach for the governmental approach, and the methods of business adjustment for the methods of forecasting.* This practical method, in place of the speculative approach, will result in basic financial reorganizations of large magnitude.

Just as at the time of the enactment of section 77, so when the pattern of reorganization method and reorganization plan was set in the 1930's by Government agencies and security holders, present-day money market conditions, interest rates, and cash positions of the companies had not been foreseen. These basic changes require basic changes in the part Government plays in the recasting of the finances of the companies, as well as changes in the spirit and viewpoint of *Government authorities when they deal with this subject.*

Above all, means can and should be devised to *bridge the chasm between Commission and courts.* The latter, together with the court-appointed trustees, can, as has been noted, *advance or defeat the use by the companies of their present unparalleled opportunities to solve their remaining financial difficulties.* At the same time, in a separate compartment, the Commission is forced to operate on reorganization matters, *virtually in a vacuum;* so long as the courts and the trustees *slow up and virtually defeat the reorganization which any competent management in possession of its own properties could effect, the Commission is put in a position where, if it has to prepare re-*

*organization plans it is dealing with a situation which disregards present-day realities.* The courts and their trustees, on the other hand, take the view *that reorganization is not to be initiated by them, but by the Commission—although nothing in the statue forbids court or trustee action to alleviate and improve the financial affairs of the railroads, even to the point of enabling solvent railroads to secure discharge from court without any need for the Commission's operation of the reorganization machinery created by section 77.*

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The court-appointed trustees are under the obligation to conduct the business affairs of the roads in such manner as to yield the largest income consistent with adequate provision of transportation service to the public. In the course of so doing, the cash resources may become sufficient to enable a company to pay its unpaid interest obligations and to be discharged from court, without any reorganization at all, and thus without effectuating any plan prepared by the Commission under the provisions of section 77.

*Similarly, the trustees should so order the affairs of these roads that they may be reorganized on a business basis, as fully as if the managements had been in control of their properties, without the custody of any court or trustee. Even if this did not result in wholly solving the problem of matured unpaid interest, it should be solved in part, as fully as possible. The remaining task for the Commission then becomes a relatively minor and mild one.*

In dealing with such matters, the trustees need the advice of the interested security holders. Their viewpoints and their interests diverge. *The bondholders should receive payment of overdue interest, with appropriate reductions to conform to money-market conditions;* insofar as payment is not presently made in full, protection for payment of the balance should be provided—this is the accepted

and practiced method for solving such problems, as is shown by the experience in the major cases under the Chandler and McLaughlin Acts. *Section 77 is broad enough for the purpose.*

The adoption, in the respects mentioned, of a changed attitude and a changed approach *will give the bondholders their due. But it will put a stop to the forfeiture of the stockholders' rights and will prevent the transfer of their property rights without compensation to some of the bondholders, additional to the principal and interest which constitute the sole rights the bondholders can claim.*

These railroad companies whose properties are still in the hands of the courts and which cannot presently pay all past interest, and the security holders of such companies, *should endeavor to pursue the same methods, to bring about the same results, which have been successful in cases not under section 77—methods not requiring the assumption of a difficult burden which may be doomed to failure, the burden of estimating the future earnings of the railroad companies and more specifically the burden of estimating those earnings in definite number of dollars.* In consequence, it would seem desirable that the caution which various groups of security holders as well as the Interstate Commerce Commission have at times felt to be necessary should be exercised once again in this field; *that the security holders and the governmental agencies involved should once more stop, look, and observe the new developments* in the finances and the affairs of the railroad industry and these railroad companies.

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The original enactment of section 77, the enactment of the 1935 amendment, and the development of reorganization procedures thereunder were effected at a time when present-day money market conditions, interest rates and cash positions of the companies had not been foreseen. *Now that it is realized that procedures developed under quite*

*different conditions and for other purposes, in the administration of a statute enacted when conditions were wholly different from those of today, actually serve to defeat the very purpose Congress and the railroad interests had in mind, it is essential that changes be made to meet the needs and the opportunities of the railroads at the present time.*

**APPENDIX C**

## UNITED STATES CIRCUIT COURT OF APPEALS

### Eighth Circuit

Nos. 13,105; 13,106; 13,107 St. Louis-San Francisco Railway Matter, Appeals from the District Court of the U. S. for the Eastern District of Missouri.

Before GARDNER, THOMAS and RIDDICK, Circuit Judges.

GARDNER, Circuit Judge, delivered the opinion of the Court.

There are here three appeals, Nos. 13,105, 13,106 and 13,107, all from an order of the District Court approving a plan or reorganization for the St. Louis-San Francisco Railway Company. As these appeals raise substantially the same questions and were consolidated for purpose of presentation, they will be considered together. The plan of reorganization reduced the capitalization of the Railway Company from about $480,000,000.00 to about $247,000,000.00 The capitalization as so reduced is less than the secured bonded indebtedness of the Railway Company by over $110,000,000.00. The plan provides for the issuance of new securities to go to the holders of the bonds. The allocation and apportionment of these securities consisting of first mortgage bonds, second mortgage bonds and stock, among the secured creditors is not here material because all the holders of the old bonds have accepted the new plan. The old bonds were all secured by various mortgage liens on the property of the Railway Company. Under the plan there is nothing apportioned to the unsecured creditors nor to the stockholders.

The appellants are the Railway Company, representing its stockholders and unsecured creditors, and Lola Brooks, Administratrix, and John E. Dikis, Administrator, who are the owners of claims allowed in the proceedings in the bankruptcy court based upon judgments against the

Railway Company on account of damages for personal injuries and death resulting from the negligence of the Railway Company prior to the period of receivership and reorganization proceedings.

The debtor's predecessor in interest was incorporated in 1876 and went into reorganization in 1896. It was again reorganized in 1916 at which time the debtor was organized to take over the properties. The capital structure of the debtor was a matter of adverse criticism by the Interstate Commerce Commission as early as 1923. By 1932 its credit became exhausted, its taxes became delinquent and its financial stability precarious. On its application for a Reconstruction Finance Corporation loan in 1932, the Commission held that it was over-capitalized, and as a condition to authorization of a Reconstruction Finance Corporation loan the Commission required the debtor to agree to submit a plan for reduction of fixed charges. Such a plan was proposed but did not become effective and receivers were appointed November 1, 1932. On May 16, 1933, the debtor filed its petition under Section 77 of the Bankruptcy Act. The 1932 plan was ultimately held inadequate to meet debtor's needs and thereafter a new plan was proposed by three bondholders' committees. This plan, after wide investigation and careful consideration by the Commission, was submitted to the Court for its approval and it is from the order entered November 16, 1944, approving that plan that these appeals are prosecuted.

The substantial objection to the plan is that the new capitalization is too low and that it should have been fixed at an amount high enough to have satisfied all secured claims and leave some equity to be allocated to the stockholders and unsecured creditors.

In the original brief filed on hebalf of the Railway Company, its stockholders and unsecured creditors, the questions at issue are stated substantially as follows: (1) The Interstate Commerce Commission proceeeded on the assumption that the rights and interests of the unsecured creditors and the debtor in debtor's assets were and are

without value, such an assumption or finding being unfair, inequitable, arbitrary and without support in the evidence; (2) that the burden of debt of the debtor as found or assumed by the Commission was determined by the trial court without correction and without any allocation of the proceeds derived from the operation of the property during reorganization, and such burden is grossly more than warranted by the evidence or the applicable law; (3) that if the earnings during reorganization period be properly applied and the debtor's earning power properly considered, there is no reasonable basis for a finding that claims of unsecured creditors and the interest of the debtor are without value.

In support of these contentions it is argued (1) that it was beyond the power of the Commission to fix the total new capitalization at an amount less than the total claims of bondholders, and (2) that the total claims of the bondholders must be computed without regard to the interest that has accumulated on their principal during the long course of reorganization proceedings. In considering these issues we must have in mind the province of the court as distinguished from the province of the Interstate Commerce Commission, as that question has been determined by controlling decisions.

Ordinarily, the underlying necessity for the reorganization of a railroad company is that it can not support its existing capitalization. Under the equity practice there was no authority vested in the court to change or recapitalize an overburdened railroad company, nor to pare down secured debts without a sale of the security. With the adoption of Section 77 of the Bankruptcy Act, however, the Interstate Commerce Commission was given the initial power of determining the new capitalization of a reorganized railroad. The Act made it possible to eliminate the foreclosure and sale under mortgages against the railway property, and conferred upon the reorganization court the power to determine the value of conflicting claims. The Act also conferred upon the Interstate Commerce Commis-

sion the duty and power of determining the new capitalization. In the determination of this important question it is necessary to ascertain the prospective earning power of the Railway Company considered as a going concern. While jurisdiction of the property of the Railway Company and its management, maintenance and operation during the process of reorganization is vested in the court, certain matters were left to the determination of the Interstate Commerce Commission, and its determination of those questions if sustained by substantial evidence and not violative of legal standards, is conclusive on the courts. *Ecker, et al. v. Western Pacific R. Corp.*, 318 U. S. 448; *Group of Investors v. Chicago, M. St. P. & P. R. Co.*, 318 U. S. 523.

Manifestly, if the value of the new securities does not exceed the amount of the secured claims, then neither the unsecured claims nor the stockholders can benefit by any change in the apportionment of the new securities. The general creditors and stockholders are confessedly junior in all resepcts to the claims of the bondholders. *Louisville Trust Co. v. Louisville, N. A. & C. R. Co.*, 174 U. S. 674; *Northern Pac. Ry. Co. v. Boyd*, 228 U. S. 482; *Case et al., v. Los Angeles Lumber Products Co.*, 308 U. S. 106. In the final analysis, the controlling if not the only question presented by these appeals is whether the action of the Commission in determining the capitalization of the Railway Company as represented by the new securities, approved by the tral court, should be set aside in order to bring about some allocation of the new securities to the general creditors and stockholders.

The Supreme Court, in *Ecker v. Western Pacific R. Corp., supra*, and *Group of Investors v. Chicago, M. St. P. & P. R. Co., supra*, has indicated the relative functions to be performed by the Commission and the reorganizing court. In the Eckert case it is said:

> "These reorganizations require something more than contests between adversary interests to produce plans which are fair and in the public interest.

When the public interest, as distinguished from private, bulks large in the problem, the solution is largely a function of the legislative and administrative agencies of government with their facilities and experience in investigating all aspects of the problem and apprasing the general interest. Congress outlined the course reorganization is to follow. It established standards for administration and placed in the hands of the Commission the primary responsibility for the development of a suitable plan. When examined to learn the purpose of its enactment, Section 77 manifests the intention of Congress to place reorganization under the leadership of the Commission, subject to a degree of participation by the court.

"It is clear from the discussions and the statute itself that there was recognition by everyone of the advantages of utilizing the facilities of the Commission for investigation into the many-sided problems of transportaton service, finance and public interest involved in even minor railroad reorganizations and utilizing the Commission's experience in these fields for the appraisals of values and the development of a plan or reorganization, fair to the public, creditors and stockholders. The resulting legislation was an attempted balance between the power of the Commission and that of the court."

Again the court said:

"The power of the court does not extend to participation in all responsibilities of the Commission. Valuation is a function limited to the Commission, without the necessity of approval by the court. * * *

"The function of valuation thus left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise. One of the primary objects of the bill was the elimination of obstructive litigation on the issue of valuation to that position as seemed to the drafts-

men legally possible. Judicial reexamination was not considered desirable. None of the findings required of the judge under subsection (e) relate specifically to valuation. Congress apparently intended to leave the determination of valuation 'of any property for any purpose under this section' to the Commission."

Again it is said:

"Another restriction on court action is that the determination as to whether the plan is 'compatible with the public interest' rests, as valuation does, with the Commission. * * *

"* * * Capitalization is an essential factor bearing on an efficient transportation system for shipper, investor and consumer. The development of the capitalization of the reorganized company which is entrusted solely to the Commission under the requirement that the plan be compatible with the public interest is that relating to the total amount of issuable securities and the quality of the securities to be issued. *So long as legal standards are followed, the judgment of the Commission on such capitalization is final.*" (Italics supplied)

Again the court said:

"Assuming at this point that the Commission's valuation is sound and reached by allowable methods, a matter discussed later in this opinion at page 477, we hold that the elimination of the claims of stockholders and creditors which are valueless from participation in the reorganization is in accordance with valid provisions of Section 77 (e)."

In *Massachusetts Mutual Lfe Ins. Co. v. Securities & Exchange Commission,* 151 F. 2d 424, we said:

"Since there is a 'rational basis' in fact for the finding of the Commission and no 'clear-cut' error of law by either Commission or court, we are not inclined to disturb the conclusion * * *."

To the same effect see: *Archer v. Securities & Exchange Commission,* 8 Cir., 133 F. 2d 795; *Board of Trade v. United States,* 314 U. S. 534.

It is clear that the Commission has the power to limit total capitalization and its finding on the question of reorganization value is not subject to review. It is urged, however, that the Commission arbitrarily assume a value, and complaint is made that the Commission did not, in words at least, find or fix the value of the property involved. In view of the very extensive investigation by the Commission of every element or factor having any conceivable bearing on the question of future earning capacity, including the condition and nature of the physical properties, the past earnings record and all circumstances which bear upon the question of future earnings or value, it can not reasonably be said that the Commission assume anything.

The Supreme Court, in *Group of Investors v. Milwaukee R. Co., supra,* speaking of the work of the Commission as reflected by the record in that case, said:

> "It reviewed freight and total revenues, passenger revenues and their trend, operating revenues and expenses, and maintenance and efficiency of operation for various periods ending in 1938. It gave consideration to estimated future taxes, emergency freight charges, and certain wage factors. It reviewed the amounts of income available for payment of interest in each of the years from 1921 to 1938. It considered the original cost of the properties, the cost of reproduction now, the cost of reproduction less depreciation, and the value for rate making purposes—each of which was substantially in excess of the capitalization which it authorized."

The investigation made by the Commission in the instant case has been as searching and as thorough as that referred to in the Milwaukee case. Here, as in the Milwaukee and Western Pacific cases, the Commission based its de-

termination as to the capitalization largely upon the earning capacity of the railroad, and in the Milwaukee case the court said:

> "Certainly there is no constitutional reason why earning power may not be utilized as the criterion for determining value for reorganization purposes."

For reorganization purposes the value depends upon its earning capacity. " * * * the commercial value of property consists in the expectation of income from it * * *." *Galveston, H. & S. A. R. Co. v. Texas,* 210 U. S. 217. As said by the Supreme Court in *Consolidated Rock Product Co. v. DuBois,* 312 U. S. 510,

> "The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various elements is to be fair and equitable."

These authorities dispose of appellants' contention that the original cost of reproduction should govern reorganization value. The determination by the Commission of the aggregate amount of securities that may be issued is in effect a finding of total value for reorganization purposes. The Commission, as has already been observed, had before it and considered every element or factor affecting value, including the evidence as to the original cost of reproduction of the physical properties. It held extended hearings at various times between July, 1933, and February, 1944, and a perusal of the record makes apposite what is said by the court below:

> "The extent of the record on these questions is appalling and it is difficult for the court to understand how anyone could contend that the Commission has omitted to go into every phase of the debtor's existence."

The trial court, in referring to the work and findings of the Commission, further said:

"The Commission has * * * gone exhaustively into the history of the debtor corporation, including the development of its physical and financial structure and that of its subsidiaries; into the characteristics of its properties and their condition and improvements; into the traffic experience, year by year, by commodities and revenue tons carried, and by flow of traffic over various parts of the system, and by the prospect for the future; into operating revenues for each year since 1915 by classes and compared by ratios to the total in the preceding year; into expenses and operating ratios since 1915, both maintenance and improvement, and into taxation; into the net earnings available for interest since the debtor has been in existence; and elaborately into the elements of physical value."

In the appeals of Brooks and Dikis, the same contentions are urged as in the appeal of the debtor, but they make some further contentions with reference to the Commission's findings. It is said that the Commission overlooked certain unmortgaged assets, namely, the cash on hand at the time of the receivership, November 1, 1932, and the cash thereafter collected by the receivers before the order segregating income for the benefit of bondholders, and it is urged that they should share in the cash assets on a parity with bondholders. As compared with the claims of bondholders, their claims are so small that their share would be negligible, if indeed not infinitesimal. The Commission found that the mortgage liens covered the entire system and that the greater part of the cash at least was subject to the lien of the various mortgages. Each of the mortgages covers all income. The trustees under the mortgages made proper demand for the income, and the court, by an order entered March 10, 1933, appointing receivers, directed the trustees to hold the mortgaged property, including the rents, issues and profits thereof. The bankruptcy court thereafter confirmed and adopted this order. The lien of the mortgages related back to the inception of the proceedings and was entitled to preference over the

competing claims of general creditors. In *Mortgage Loan Co. v. Livingston,* 45 F. 2d 28, we said:

> "So here, the receiver, while not appointed in a separate suit instituted by the mortgages, was functioning on behalf of all creditors with due regard to priorities of claims and liens on the property of the bankrupt."

See, also: *In re Wakey,* 7 Cir., 50 F. 2d 869; Central *Hanover Bank & Tr. Co. v. Philadelphia & Reading Coal & Iron Co.,* 3 Cir., 99 F. 2d 642.

Any equitable interest which Brooks and Dikis may assert in the mortgaged property is subject to the payment of the bonds, as the existence of a junior lien does not unsettle the rights of the senior claimants. *Louisville Tr. Co. v. Louisville, N. A. & C. R. Co., supra; Case et al v. Los Angeles Lumber Products Co., supra.*

It is also urged by Brooks and Dikis that they were in fact not general creditors, but entitled to some preferential treatment. True, they may have liens in the states in which their judgments were entered but these liens are subject to pre-existing liens and certainly junior to the lien of the bondholders. It is also urged that they were entitled to priority of payment under the equity rule allowing priority to those who furnish material for the operation of a railroad within a limited time before receivership. Proceedings to determine that question seem to be pending and we do not believe a plan of reorganization should embody an adjudication or classification of individual claims, and we express no opinion on the question.

Again, it is urged that there are current assets of the value of $50,000,000.00 which should be available to pay debts. From the current assets on hand the court ordered payment of the 1945 interest, and manifestly, the Railway Company as a going concern can not, even for the purpose of paying creditors, be left stranded for want of operating funds. These so-called funds on hand belonged to the Railway Company and while they may tend to enhance some-

what the value of the new stock and bonds, these stocks and bonds are held by those who have preferred claims and if the funds could be taken from the company for the purpose of paying debts they should be applied upon the remaining unsatisfied preferred claims of the bondholders, so that no possible benefit could inure to the stockholders or unsecured creditors. The finding of the Commission as to the amount due on the preferred claims is challenged and it is argued that the bondholders were not entitled to interest from the time of the initiation of the reorganization proceedings. The argument, however, overlooks the fact that the property in reorganization was all subject to the mortgage liens and these mortgages cover not only the payment of the principal but also the payment of interest. Interest on secured claims to the effective date of the plan is entitled to the same priority as the principal. *Consolidated Rock Products Co. v. DuBois, supra; Ecker v. Western Pacific R. Corp., supra; Case v. Los Angeles Lumber Products Co., supra; Louisville Joint Stock Land Bank v. Radford,* 295 U. S. 555; *American Iron & Steel Mfg. Co. v. Seaboard Air Line Railway,* 233 U. S. 261; *Group of Investors v. Milwaukee R. Co., supra.* The time as of which the claims of creditors should be computed was fixed as January 1, 1944. From that time the interest on the securities will be the new rate, but up to that time it will be computed on the old securities at the contract rate. This determination, we think, is reasonable and equitable and violative of no legal principle.

In a reply brief filed by the debtor subsequent to oral argument on leave of court, it is suggested that the decision of this case be held until it is determined whether there will be an order of confirmation brought to this court on appeal, and that such an appeal should be considered before we decide the issues in the present appeal. We can see no justification for further delay. We need not here anticipate what questions for review might be presented on such an appeal further than to observe that Section 77 provides that when a plan is approved by the Commsision and

the District Court, it shall then be submitted to the security holders whose interests are of value and are affected by the plan, and after vote by them it shall come again to the District Court to be confirmed. If the plan is accepted by more than two-thirds of those voting in each class to which submission is required, then the District Court, we think, will not again consider the merits of the plan. If the plan has been accepted and the acceptance has been properly obtained it will then be confirmed. In the instant case, the plan has already been accepted by more than two-thirds of those voting in each class to which the submission was required. Certainly, in those circumstances there should be no further delay in this proceeding which has already been pending for more than twelve years.

As the order appealed form is sustained by substantial evidence and the Commission in reaching its determination has applied proper standards as declared by controlling decisions of the Supreme Court, it is affirmed.

**APPENDIX D**

**Remarks of Judge Evans of the Seventh Circuit in Rock Island Reorganization, No. 8930.**

JUDGE EVANS: One point which gives me some anxiety is that in the Supreme Court it was said valuation was a matter of income, in the St. Paul case didn't think that the question of valuation was to be determined by an appraisal of the property, but by the income.

MR. BROWN: Yes, your Honor.

JUDGE EVANS: That income has changed so radically from the time that valuation was first fixed that it is hard to assume that the valuation was correct.

MR. BROWN: Yes, that is perfectly true. But, in the Milwaukee decision there was some war earnings. But, no one contends that the Rock Island earnings of the last three or four years are going to be earnings on which a permanent plan should be based.

JUDGE EVANS: That might be, but it did show, apparently, and lots of people have rather indicated that they believe that increased or swollen income will be, in part, carried on through because of what has taken place in railroad management, in equipment, and so forth, during the last ten years; in other words, valuation based upon income. While railroad income during the war would be greater than in peace, probably, that income will be larger than the amount upon which the original valuation was based.

MR. BROWN: I don't think there is anything in the record in this case, I am sure there is nothing in the record in this case, hearing this appeal on its full merits and full record upon which this Court could determine whether the Rock Island earnings for the next three years, or the next one year, can be expected to continue. The record that will come to your Honors on this full appeal will be only historical earnings.

JUDGE EVANS: We may be bound by judicial prece-

dent, which is quite strong in your favor, in the St. Paul case. But, where they tried to get in was when the plan went back from the District Court to the Commission and the Commission says only the questions that caused the Court not to approve, only those questions will be considered—in other words, then was the time, probably, if the Interstate Commerce Commission was desirous of doing complete justice and ascertaining, or checking on itself: Did we make the correct finding of the value of this railroad?—when to our great surprise and to the great surprise of everybody else, something happened, to wit, war, and the revenues just doubled. If you start with a value that is going to be determined on the basis of revenues and something happens that causes revenues to double, then it comes back—"Well, how about it?" And: "No, we won't go back of it, we will stick by what we said." Is that entirely right?

MR. BROWN: If we follow that line of thought, it is impossible for me to say, or understand how the Rock Island can be reorganized within less than ten years from now.

JUDGE EVANS: Maybe so, but there is also the thought that if it takes ten years to get it right it is pretty nearly right to do it.

I had quite a little part in the St. Paul Railroad, and it was always shocking to think that there should be such an absolute denial of any right for any stockholder, notwithstanding that money was just rolling into the St. Paul and the North Western Railroad, but notwithstanding that, it was decided, "You are out." That don't set very well on your conscience. If you did it wrong, it is about time you correct it.

Of course, we don't want any longer reorganization of this railroad than is necessary. But, there was quite a big difference between the first one and the last one, attributable to a difference in revenue, due to, we will say, primarily to war, but not entirely. There has been a tre-

mendous change in operation and management, and so forth, of railroads. No man can ride on a railroad and not see it and not have it outlined to him. It is not alone the convenience and the amount of tons of freight hauled by one engine, but the cost per mile of hauling is startling. It has all taken place, it seems to me, in the last ten or fifteen years. It is truly remarkable it had to be a period of depression, and almost a loss of all railroads, that they should wake up and go after the business as they should have done long before, instead of merely figuring on refinancing that has been the mistake of the railroads.

MR. BROWN: I am in full agreement with the last portion of your remarks. My difficulty comes from my belief that this Court was right when it indicated that Section 77 did not contemplate an indefinite nursing receivership. I don't believe it contemplates a holding of the railroad under the umbrella of the chancellor while we see whether the next ten years will continue the remarkable war earnings, or whether we will see something other than that. You cannot predict future earnings on the earnings of the Rock Island in the last few years.

JUDGE EVANS: If I remember correctly, Justice Sutherland wrote the opinion in the Rock Island case, and we both commented on the delay in these reorganizations, and we thought about two years ought to be long enough to reorganize, and it has been twelve years, and we haven't got it yet.

MR. BROWN: I think the parties thought so, too.

JUDGE EVANS: I also realize that in ten years I have never seen such a change in railroad operation and railroad revenue: I never had my confidence in my judgment of valuation so shaken as it was when the returns began to come in from railroad operation during the war period, when previously common and preferred stocks were wiped out with a sweep of the hand, and in the next year they made enough so that that stock that was wiped out could have received 10 cents on the dollar and still have something left in the treasury.

(2)

FILED
APR 15 1946
CHARLES ELMORE CROPLEY
CLERK

# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1945**

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## Nos. 1108-1111

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ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, DEBTOR, LOLA BROOKS, ADMINISTRATRIX OF THE ESTATE OF F. S. BROOKS, DECEASED, ET AL.,

*Petitioners,*

*vs.*

FORT SCOTT BONDHOLDERS' COMMITTEE, BANKERS TRUST COMPANY, TRUSTEE FOR THE KANSAS CITY, FORT SCOTT & MEMPHIS R. CO., ET AL.

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**APPENDIX TO PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.**

INTERSTATE COMMERCE COMMISSION

# ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY REORGANIZATION

SUBMISSION OF PLAN OF REORGANIZATION
PURSUANT TO SECTION 77 OF THE
BANKRUPTCY ACT, AS AMENDED

FINANCE DOCKET NO. 10008

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WASHINGTON, D. C.

June, 1945

*In cooperation with national conservation of wood pulp, by order of the Company, this pamphlet is printed on non-critical Ecusta flax paper*

## PLAN OF REORGANIZATION OF ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY APPROVED BY THE COMMISSION IN ITS ORDER OF JULY 4, 1944, AND BY THE COURT, IN ITS ORDER ENTERED APRIL 10, 1945.

*Distribution of cash and new securities per $1,000 of present bonds with accrued interest*[1]

| | Cash | First mortgage bonds | Second mortgage bonds | Preferred stock | Common stock, shares |
|---|---|---|---|---|---|
| Fort Scott, 4's | $61.34 | $733 | $267 | | |
| Prior lien, series A, 4's | 15.36 | 219 | 171 | $332 | 6.67 |
| Prior lien, series B, 5's | 25.39 | 233 | 182 | 353 | 7.10 |
| Consolidateds, series A, 4½'s | 21.05 | 221 | 158 | 174 | 3.48 |
| Consolidateds, series B, 6's | 36.22 | 243 | 174 | 191 | 3.83 |

[1] See hereinafter in plan for the treatment of the creditor banks.

*Time of consummation of the plan.*—The plan shall be consummated by the issue and delivery of the new securities provided for in the plan as soon as practicable after confirmation of the plan and the reorganization managers shall publish, as directed by the court, notice of the date as of which the new securities are to be or shall have become available for delivery. The court on application of the reorganization managers shall, in the light of the date or dates as of which the delivery of the properties to the reorganized company, the execution of the new mortgages, and the issue and the delivery of the new securities have been, or are expected to be, accomplished, by order determine a convenient and appropriate date for giving effect to the plan (such date being herein called the consummation date). The debtor shall be discharged upon the consummation date from all its obligations other than claims to be paid or to be assumed by the reorganized company, as hereinafter provided, and all mortgage bonds, notes, certificates and shares of stock, and other obligations of the debtor or enforceable against the debtor or its property, other than as aforesaid, shall, on and after the consummation date, become void and unenforceable against the debtor or its successors or their property. Prior to the consummation date, however, the plan shall not affect any claims of creditors, and any distribution of cash prior to the consummation date shall be in respect of the old securities. The new securities shall be dated as of the first day of the calendar month in which the consummation date falls, or, if interest accruing on the unpaid principal of the Fort Scott bonds outstanding and pledged at 4 percent per annum from December 31, 1943, to said date shall not have been paid by cash distributions as hereinafter provided, to the latest date to which such interest shall have been paid.

The consummation of the plan shall not require any retroactive change in the operations of the bankruptcy trustees or in their accounts or in the reports made to the Commission or in any other reports or returns for the period prior to the consummation date.

*Reorganized company.*—All property of the debtor, and of its trustees appointed in the proceedings for its reorganization, shall be trans-

ferred to a new corporation, or, in the discretion of the reorganization managers with the approval of the court, shall be retained by, or transferred to, the debtor. As herein used, the term "reorganized company" means the corporation, whether the debtor or the new corporation, which shall issue the securities herein provided for. The reorganized company, if not the debtor, shall be incorporated under the laws of such State as the reorganization managers, with the approval of the court, shall determine, the laws of any other State to the contrary notwithstanding. If the court shall so direct, there shall also be transferred to the reorganized company all or any part of the property of any wholly owned subsidiary of the debtor, and any securities of such subsidiary may, in such event, be canceled; if there shall be so transferred to the reorganized company all or any part of the property of any wholly owned subsidiary of the debtor owning or operating railroad properties in the State of Texas, the reorganized company shall have its general offices at such place as the court may direct, the laws of any State to the contrary notwithstanding. Any transfer of property from any subsidiary to the reorganized company may be effected by merger, consolidation, transfer of assets, or any other means approved by the reorganization managers. All such transfers shall be made subject to and in accordance with the plan.

*New capitalization.*—The capitalization of the reorganized company upon consummation of the plan shall be substantially as shown below, subject to variation (*a*) by reason of payment or reduction of equipment obligations or the incurring of additional equipment obligations, and (*b*) to the extent necessary to avoid the issue of scrip in amounts not expressible in even dollars or even hundredths of a share:

| | *Amount* |
|---|---|
| Equipment obligations, undisturbed (as of January 1, 1944) | $ 2,986,000 |
| First-mortgage, series A, 4-percent bonds | 73,385,342 |
| Second-mortgage, series A, convertible 4½-percent income bonds | 47,549,826 |
| Preferred stock, series A, 5 percent, par value $100 a share | 61,859,782 |
| Common stock without par value, 1,241,158 shares stated at $50 a share | 62,057,858 |
| Total | 247,838,808 |

*Disposition of old securities.*—Upon consummation of the plan and the issue and distribution of new securities as herein provided, all mortgage bonds, notes, and other securities and indebtedness of the debtor (except equipment obligations which remain undisturbed) outstanding or held by the bankruptcy trustees, including any of such securities pledged, all mortgage bonds, notes, certificates and shares of stock, and other securities and indebtedness of St. Louis and San Francisco Railway Company or St. Louis and San Francisco Railroad Company (other than $1,000, principal amount, trust-mortgage bonds, due 1987, of St. Louis and San Francisco Railway Company), and all mortgage bonds, notes, certificates and shares of stock, and other securities and indebtedness of Kansas City, Memphis and Birmingham Railroad

Company or the Kansas City, Fort Scott & Memphis Railway Company outstanding or held by the bankruptcy trustees, including any of such securities pledged, shall be surrendered to the reorganization managers and canceled, and all the mortgages on properties acquired or to be acquired under the plan by the reorganized company (other than the mortgages created pursuant to the plan) shall be satisfied of record and canceled. Upon consummation of the plan, the reorganization managers may, with the approval of the court, cause to be canceled all mortgage bonds, notes, shares and certificates of stock, and other securities and indebtedness of predecessor and constituent corporations of the debtor, and all mortgage bonds, notes, shares and certificates of stock, and other securities and indebtedness of wholly owned subsidiaries of the debtor, the properties of which are acquired under the plan by the reorganized company, and whether such mortgage bonds, notes, shares and certificates of stock, and other securities and indebtedness, in any of the above cases, are then held by the bankruptcy trustees or are in pledge, and procure the dissolution of any such corporations which shall not own any property upon consummation of the plan.

*First-mortgage bonds.*—The new first-mortgage bonds shall be secured by a new, open, first mortgage constituting a first lien, subject only to the liens of equipment-trust obligations or other obligations for the deferred or serial payment of all or a part of the purchase price of equipment (herein called equipment obligations), on all properties and assets, including securities and leaseholds, owned by the reorganized company upon consummation of the plan and, subject to liens and mortgages in existence at the time of acquisition and to such purchase-money liens and mortgages as may be permitted by the first mortgage (including equipment obligations), upon all property acquired by the reorganized company after reorganization, except such property, if any, (whether owned upon consummation of the plan or thereafter acquired), as the reorganization managers with the approval of the court may determine to exclude; provided however, that (*a*) if the reorganized company shall acquire the properties of any other company (other than a subsidiary wholly owned at the time of consummation of the plan) constituting a class 1 carrier, such properties shall not be subject to the lien of the first mortgage unless they are lien properties as defined below and (*b*) if the reorganized company shall be consolidated with, or merged into, or shall sell its assets substantially as an entirety to, any other class 1 carrier (other than a subsidiary wholly owned at the time of consummation of the plan), no properties theretofore owned or thereafter acquired by such other company, or by the company resulting from such consolidation, shall be subject to the lien of the first mortgage except such thereof as shall be lien properties as defined below. Lien properties, for the purpose of the next preceding sentence, shall include all properties which shall be appurtenant or incident to properties subject to the lien of the first mortgage or which shall consist of any line of railroad, or securities representing control thereof, which will displace or otherwise adversely affect the use thereof made of, or have the effect of diverting traffic from, any line of railroad then subject to the first mortgage, or which shall be within the maintenance or replacement covenants of the first mortgage or which shall be acquired in whole or in part by the use of first-

mortgage bonds or second-mortgage bonds, or moneys deposited under the first mortgage or the second mortgage.

The first mortgage shall contain a convenant that the reorganized company will at all times keep the mortgaged property supplied with such amount of motive power, rolling stock, and equipment (on which the first mortgage shall constitute a first lien subject only to such liens in the nature of purchase-money liens, including equipment obligations, as may be permitted by the terms thereof), and maintain the same in such condition, as may be necessary for the efficient and economical operation of the mortgaged property.

First-mortgage bonds may be issued from time to time without limit as to aggregate amount in different series, subject to such limitations and restrictions as may be specified in the first mortgage, payable on such date or dates, in such denominations, bearing interest at such rates, and containing such provisions in regard to sinking funds, redemption, conversion, taxes, place or places, and money or moneys of payment and registration, and having such other characteristics as may be prescribed by the board of directors of the reorganized company at the time of issue, but, with respect to the lien of the first mortgage, all equally secured except in respect of any sinking fund created for the benefit of any particular series.

First-mortgage bonds, series A, shall not be limited in authorized principal amount, and shall be issued, on consummation of the plan, in the amount necessary to carry out the terms of the plan.

First-mortgage bonds, series A, shall mature 50 years after their date, shall bear interest at the rate of 4 percent per annum payable semiannually, and shall be redeemable as a whole or in part at any time on 30 days' notice, at their principal amount and accrued interest, plus a premium of 5 percent if redeemed within 10 years from their date, such premium decreasing by one-half of 1 percent at the beginning of each successive subsequent 4-year period, so that there shall be no premium on redemption during the last 4 years prior to maturity. Bonds of series A shall be redeemable for the sinking fund at the principal amount thereof plus accrued interest.

The first mortgage shall provide for the payment on May 1 of each year, while any series A bonds are outstanding, of an installment of sinking fund in an amount equal to (*a*) one-fourth of 1 percent of the maximum principal amount of series A bonds theretofore at any time authenticated and uncanceled and (*b*) interest on bonds and other obligations acquired by operation of the fund that would have been chargeable to income if the bonds and other obligations so acquired had remained outstanding. Such sinking-fund installments shall be payable only out of net income as hereinafter provided. Amounts in said sinking fund shall be applied to the retirement of first-mortgage bonds or obligations collaterally secured by not less than an equal principal amount of first-mortgage bonds, by purchase, payment or redemption, all as shall be provided in the first mortgage. All first-mortgage bonds or other obligations acquired by the operation of the sinking fund shall be held in the sinking fund and continue to draw interest, which shall be paid into the fund, so long as any series A bonds are outstanding, but shall not be deemed outstanding for any other purpose, and no bonds or other obligations shall be issued in lieu thereof.

The first mortgage shall provide that the board of directors of the reorganized company may create an additional sinking fund or sinking funds in respect of the issue of first-mortgage bonds of series other than series A, and that any such sinking fund or sinking funds may be subordinated to, or may rank equally and ratably with, but not prior to, the sinking fund established in respect of the issue of bonds of series A.

First-mortgage bonds, in addition to those to be issued in the reorganization, may be authenticated from time to time, with all requisite approval of public regulatory authority, as follows:

(*a*) To refund first-mortgage bonds (excluding bonds retired by operation of any sinking fund or pursuant to clause (3) of subparagraph (*d*) of this paragraph) or obligations secured by mortgage liens prior to the lien of the first mortgage, or obligations secured by first-mortgage bonds to the extent so secured; or

(*b*) Upon the deposit of cash equal to the principal amount to be issued; or

(*c*) To provide for, or to reimburse the reorganized company for, not exceeding 75 percent of expenditures made after consummation date which under applicable accounting rules are properly chargeable to capital account; provided, however, that (1) the said 75 percent shall be applied to the net amount of capital expenditures after making deductions from gross capital expenditures to such extent and on such basis as may be specified in the first mortgage for depreciation, amortization, and retirements of roadway and structures; (2) if any property shall be acquired subject to existing liens, the amount of additional first-mortgage bonds issuable therefor, or issuable to refund prior-lien obligations thereon, together with the aggregate amount of existing liens to which such property is subject, shall not exceed 75 percent of the cost thereof, including as part of such cost the amount of such existing liens whether or not the indebtedness secured thereby is assumed by the reorganized company; and (3) no bonds shall be issued on the basis of the acquisition of equipment (other than equipment acquired with the line or terminal by which it was owned and operated for the purposes of such line or terminal) or on the basis of the construction of equipment or on the basis of additions and betterments to equipment or refund equipment obligations; or

(*d*) Bonds, hereinafter referred to as "emergency bonds," may be issued and sold or pledged without regard to any of the restrictions contained in the plan, except those in this subparagraph (*d*), upon resolution adopted by the vote of two-thirds of the entire number of directors that funds are needed and cannot be raised except by sale, exchange, or pledge of the bonds applied for; provided, however, that (1) if all emergency bonds (or a like principal amount of other first-mortgage bonds) are not retired and canceled within 2 years from the date of issue, there shall thereafter, until such retirement is accomplished, be an additional annual sinking fund (hereinafter called the emergency-bond sinking fund), equal to 10 percent of the maximum principal amount of emergency bonds theretofore outstanding at any time since the last previous time when no emergency bonds were outstanding to be paid as hereinafter provided in the subparagraphs relating to application of available net income, and applicable in the

same manner as above provided in respect of the series A sinking fund; (2) the amount of emergency bonds outstanding shall not exceed at any one time $10,000,000; and (3) the reorganized company shall reacquire all emergency bonds (or a like principal amount of other first-mortgage bonds outstanding or pledged) as soon as practicable, and all such bonds so reacquired by the reorganized company shall forthwith be surrendered to the trustee under the first mortgage for cancelation.

The amount of emergency bonds outstanding at any time shall be deemed to be the principal amount of first-mortgage bonds theretofore at any time authenticated pursuant to the foregoing, less (*a*) the amount of first-mortgage bonds retired and canceled (when any emergency bonds are outstanding) under such circumstances that no first-mortgage bonds may be issued in lieu thereof and (*b*) the amount of first-mortgage bonds otherwise issuable, the privilege of issuing which shall, when any emergency bonds are outstanding, have been irrevocably waived.

The first mortgage shall contain a covenant to the effect that no first-mortgage bonds, other than those to be issued under the plan, shall be sold or pledged by the reorganized company unless the board of directors of the reorganized company shall, by resolution adopted by two-thirds of the entire number of directors, have determined that, in the opinion of the board, taking into account market and other relevant conditions at the time, it is impracticable to provide the amount of money needed (1) by the sale of second-mortgage bonds having a suitable maturity at a price which would give a yield to maturity of 5 percent or less, or (2) by the sale of preferred stock at a price which would give a current dividend return of 6 percent or less, or (3) by the sale of common stock at a price which would give a current dividend return of 6 percent or less, based on the regular dividend rate then in effect, or, if no regular rate is in effect, based on the average rate at which dividends have been paid during the past 12 calendar months, or if no dividends have been paid during the past 12 calendar months, based on a dividend rate of $3 per share per year.

The first mortgage shall contain a covenant that (*a*) the excess of the principal amount of first-mortgage bonds at any time pledged over the principal amount of indebtedness secured by pledge of first-mortgage bonds shall not exceed 10 percent of the aggregate principal amount of all first-mortgage bonds then outstanding, including bonds pledged but excluding bonds held in the treasury of the reorganized company and (*b*) the excess of the aggregate principal amount of first-mortgage bonds and second-mortgage bonds at any time pledged over the principal amount of indebtedness secured by such pledge shall not exceed 10 percent of the aggregate principal amount of all first-mortgage bonds and second-mortgage bonds then outstanding, including bonds pledged but excluding bonds held in the treasury of the reorganized company.

The first mortgage shall provide, within conditions and limits to be therein prescribed, for the modification and alteration thereof and of any or all supplements thereto, and of the rights and obligations of the reorganized company and of the holders of the bonds issued thereunder, at any time, with all requisite approval of public regulatory authority, by the concurrent action of the reorganized company and of the holders of not less than two-thirds of the aggregate principal amount of bonds

then outstanding affected by such modification or alteration; and, without limitation, such modification or alteration may specifically include procedural provision for ascertaining available net income without the maintenance of separate books of account, in the event that the reorganized company shall be merged into or consolidated or unified with another class I carrier, whether or not a subsidiary of the reorganized company; provided, however, that no such modification or alteration shall (*a*) alter or impair the obligation of the reorganized company to pay the principal of, or interest on, any bond at the time and place and at the rate and in the currency provided therein, (*b*) permit the creation by the reorganized company of any mortgage or lien in the nature of a mortgage ranking prior to or on a parity with the lien of the first mortgage, except as in the first mortgage otherwise expressly provided, or (*c*) alter the provisions of the first mortgage conforming to this sentence and the next following sentence. Notwithstanding the limitation in the foregoing clause (*a*) of this paragraph, the first mortgage shall provide that the obligation of the reorganized company to pay the principal of and/or interest on first-mortgage bonds may, with all requisite approval of public regulatory authority, be modified by the concurrent action of the reorganized company and of the holders of not less than three-fourths in aggregate principal amount of the bonds affected by such modification then outstanding, so as to postpone the time of payment of all or any part of such principal and/or interest; provided, however, that if the reorganization managers shall advise the court that, in their opinion, the inclusion of the foregoing provision in the first mortgage would impair the negotiability of the first-mortgage bonds, and that such impairment would, in their opinion, be materially disadvantageous, and the court shall so decide, the foregoing provision may be modified by the reorganization managers to the extent necessary to prevent any impairment of negotiability.

*Special reserve fund.*—Immediately after the consummation date the reorganized company shall set aside in a special bank account, out of the cash turned over to it by the bankruptcy trustees, the sum of $500,000. Moneys from time to time in said special account (herein called the special reserve fund) may be used only (1) for investment in securities issued by the United States Government, the proceeds of which upon payment or sale, shall be restored to the special reserve fund; or (2) to pay fixed charges of the reorganized company; or (3) for capital expenditures; provided, however, that no part of the special reserve fund shall be used for payment of fixed charges or for capital expenditures unless the board of directors shall, by resolution adopted by the affirmative vote of two-thirds of the entire board, (*a*) authorize such use; (*b*) determine that funds necessary for payment of fixed charges or for capital expenditures are unavailable from other sources; and (*c*) in case the special reserve fund is to be used for capital expenditures, determine that such capital expenditures are essential for the safe operation of the properties of the reorganized company or for the realization of customary standards of efficiency or economy in the operation of such properties.

If, at any time, the sum of cash in the special reserve fund and the principal amount of United States Government obligations in which

moneys in the special reserve fund are then invested (such sum being hereinafter called the special reserve fund balance) is less than $500,000, no dividends shall thereafter be paid on common stock unless and until an amount equal to such deficiency shall have been deducted from available net income which would otherwise be applicable to the payment of dividends on common stock and transferred to the special reserve fund.

*Second-mortgage bonds.*—The new second mortgage shall constitute a lien, subject to the lien of the first mortgage, on all property from time to time subject to the lien of the first mortgage.

Second-mortgage bonds may be issued from time to time without limit as to aggregate amount in different series, subject to such limitations and restrictions as may be specified in the second mortgage, payable on such date or dates, in such denominations, bearing interest at such rates, and containing such provisions in regard to accumulations of interest, sinking funds, redemption, conversion, taxes, place or places, and money or moneys of payment and registration, and having such other characteristics, as may be prescribed by the board of directors of the reorganized company at the time of issue, but, with respect to the lien of the second mortgage, all equally secured except in respect of any sinking fund created for the benefit of any particular series. No interest shall be mandatorily payable on second-mortgage bonds, except at maturity by expiration of the term or at redemption, otherwise than out of available net income, as hereinafter provided. The second mortgage shall contain provisions permitting the extension of any first-mortgage bonds or other obligations secured by lien prior to the lien of the second mortgage from time to time outstanding.

Series A bonds shall not be limited in authorized principal amount, and shall be issued, on consummation of the plan, in the amount necessary to carry out the terms of the plan. They shall mature 75 years after their date, and shall bear contingent interest at the rate of 4½ percent per annum payable, as in the following paragraph hereof provided, annually on the first day of May in each year, and shall be redeemable as a whole or in part at any time on 30 days' notice, at their principal amount plus (*a*) interest at the rate of 4½ percent per annum for the last preceding calendar year, if not theretofore paid, whether or not earned, (*b*) all unpaid accumulated interest for prior years, and (*c*) interest at the rate of 4½ percent per annum from the end of the last preceding calendar year to the redemption date. The series A bonds shall have a conversion privilege and be entitled to the benefits of a sinking fund as hereinafter provided.

Interest on the bonds of series A accruing for each calendar year shall, up to the limits of accumulation hereinafter specified, become absolutely owing as a debt on December 31 in such year, but shall be payable on May 1 of the next succeeding year or thereafter as provided below. Such interest shall be mandatorily payable, except as herein provided, only when the available net income of the reorganized company is sufficient for the payment thereof upon the application of such available net income as hereinafter provided. All interest not paid because of the limitation in the last preceding sentence shall accumulate up to the maximum accumulation of 18 percent, but not beyond. Interest accruing in any year which is paid on May 1 in

the next succeeding year shall not be included in calculating the 18 percent. Accumulated interest shall be mandatorily payable (*a*) whenever, and to the extent that available net income is sufficient for the payment thereof upon the application of such available net income as hereinafter provided, in which case such amount shall be paid on the next following May 1, or (*b*) in any event, whether earned or not, at the maturity or on redemption of the second-mortgage bonds.

Upon the maturity of the series A bonds, whether by acceleration or otherwise, there shall be paid (*a*) interest at the rate of 4½ percent per annum for the last preceding calendar year, if not theretofore paid, whether or not earned, (*b*) all unpaid accumulated interest for prior years, and (*c*) interest at the rate of 4½ percent per annum from the end of the last preceding calendar year to the date of maturity.

All interest after maturity shall be a fixed obligation. The board of directors may, in its discretion, at any time pay any interest on second-mortgage bonds, which is at the time accumulated or currently accrued but not mandatorily payable, out of any funds lawfully available therefor, but only if the board of directors shall, by resolution adopted by the affirmative vote of two-thirds of the entire board, determine that the funds to be used for such payment are not needed for additions and betterments that are necessary or desirable for the safe operation of the properties of the reorganized company or for the realization of customary standards of efficiency or economy in the operation of such properties.

To compensate for any reduction of interest payments on the second-mortgage bonds through utilization of subparagraph (1) hereinafter set forth relating to the application of available net income, the second mortgage shall contain a covenant substantially to the effect that if the amount of interest paid or payable on second-mortgage bonds shall have been reduced by any appropriation from available net income for capital expenditures pursuant to said subparagraph (1), the amount of any such reduction shall be supplied from available net income and distributed pro rata among holders of outstanding second-mortgage bonds, in addition to any other interest required to be paid thereon, before any dividend shall be paid on preferred stock or common stock.

Until called for redemption, the bonds of series A shall, at the option of the holders, be convertible into shares of common stock, as at the time constituted, at any time within 5 years after the date of such bonds, at the rate of 30 shares for each $1,000 principal amount of such bonds, and at any time thereafter at the rate of 25 shares for each $1,000 principal amount of such bonds.

The second mortgage shall provide for an annual sinking-fund payment for series A bonds to be made on each May 1 so long as any series A bonds are outstanding, from available net income as hereinafter provided, in an amount equal to one-half of 1 percent of the maximum principal amount of series A bonds theretofore at any time authenticated and uncanceled. The series A sinking fund shall be applied from time to time to the retirement of series A bonds by purchase or redemption, as provided in the second mortgage. All bonds of series A purchased or redeemed by operation of the sinking fund shall be forthwith canceled, and no bonds shall be issued in lieu thereof.

Sinking funds may be provided for other series of second-mortgage bonds, and any such sinking fund or sinking funds may be subordinated to, or may rank equally and ratably with, but not prior to, the sinking fund for the bonds of series A.

Second-mortgage bonds, in addition to those to be issued in the reorganization, may be authenticated from time to time, with all requisite approval of public regulatory authority, as follows:

(1) For the purposes and subject to the restrictions contained in the plan in respect of the issue of additional first-mortgage bonds, to the extent that first-mortgage bonds are not issued for such purposes; provided, however, that no emergency bonds may be issued under the second mortgage; and (2) to refund second-mortgage bonds (excluding bonds retired by operation of any sinking fund) or obligations secured by second-mortgage bonds, to the extent so secured.

The second mortgage shall contain a covenant to the effect that no bonds, other than those to be issued under the plan, may be sold or pledged by the reorganized company unless the board of directors of the reorganized company, by resolution adopted by two-thirds of the entire number of directors, shall have determined that in the opinion of the board, taking into account market and other relevant conditions at the time, it is impracticable to provide the amount of money needed (1) by the sale of preferred stock at a price which would give a current dividend return of 6 percent or less, or (2) by the sale of common stock at a price which would give a current dividend return of 6 percent or less, based on the regular dividend rate then in effect, or, if no regular rate is in effect, based on the average rate at which dividends have been paid during the past 12 calendar months, or if no dividends have been paid during the past 12 calendar months, based on a dividend rate of $3 per share per year.

The second mortgage shall contain a covenant that (*a*) the excess of the principal amount of second-mortgage bonds at any time pledged over the principal amount of indebtedness secured by pledge of second-mortgage bonds shall not exceed 10 percent of the aggregate principal amount of all second-mortgage bonds then outstanding, including pledged second-mortgage bonds but excluding second-mortgage bonds held in the treasury of the reorganized company and (*b*) the excess of the aggregate principal amount of first-mortgage bonds and second-mortgage bonds at any time pledged over the principal amount of indebtedness secured by such pledge shall not exceed 10 percent of the aggregate principal amount of all first-mortgage bonds and second-mortgage bonds then outstanding, including bonds pledged but excluding bonds held in the treasury of the reorganized company.

The second mortgage shall contain a covenant with regard to the maintenance and replacement of equipment similar to the corresponding covenant in the first mortgage heretofore described and shall also contain appropriate covenants to carry out the provisions heretofore stated relative to the special reserve fund.

The second mortgage shall provide, within conditions and limits to be therein prescribed, for the modification and alteration thereof, and of any or all supplements thereto, and of the rights and obligations of the reorganized company and of the holders of bonds issued thereunder, at any time by the concurrent action of the reorganized company and of the holders of not less than two-thirds of the aggregate

principal amount of bonds then outstanding affected by such modification or alteration; and, without limitation, such modification or alteration may specifically include procedural provision for ascertaining available net income without the maintenance of separate books of account, in the event that the reorganized company shall be merged or consolidated or unified with another class I carrier, whether or not a subsidiary of the reorganized company; provided, however, that no such modification or alteration shall (*a*) alter or impair the obligation of the reorganized company with respect to the determination and application of income available for interest on the second-mortgage bonds (except as herein specifically provided) or with respect to the payment of the principal amount of or accumulated interest on any second-mortgage bonds at the time and place, at the rate and in the currency provided therein, (*b*) permit the creation by the reorganized company of any mortgage or lien in the nature of a mortgage ranking prior to or on a parity with the lien of the second mortgage, except as in the second mortgage otherwise expressly provided, or (*c*) alter the provisions of the second mortgage conforming to this sentence and the next following sentence. Notwithstanding the limitations in the foregoing clauses (*a*) and (*b*) of this paragraph, the second mortgage shall provide that the obligation of the reorganized company referred to in said clause (*a*) may be modified, and mortgages or liens referred to in said clause (*b*) may be created, with all requisite approval of public regulatory authority, by the concurrent action of the reorganized company and of the holders of not less than three-fourths in aggregate principal amount of the bonds affected by such change then outstanding; provided, however, that if the reorganization managers shall advise the court that, in their opinion, the inclusion in the second mortgage of a provision permitting modification of the obligation of the reorganized company referred to in said clause (*a*) would impair the negotiability of the second-mortgage bonds, and that such impairment would, in their opinion, be materially disadvantageous, and the court shall so decide, the provision permitting such modification may be modified by the reorganization managers to the extent necessary to prevent any impairment of negotiability.

If the applicable accounting rules shall have been so changed as substantially to reduce the amounts of cash available for capital expenditures from sources other than available net income, the provisions of the second mortgage may be modified (notwithstanding the limitations in the last preceding paragraph) by the concurrent action of the reorganized company and of the holders of not less than a majority of the aggregate principal amount of bonds then outstanding, so as to permit the deduction of amounts for capital expenditures before determining available net income or to increase the appropriation for capital expenditures permitted by subparagraph (1), hereinafter set forth relating to application of available net income.

*Ascertainment and disposition of available net income.*—Available net income shall be determined for each calendar year that begins after the calendar year in which the new securities shall be dated, and for that part of the calendar year in which the new securities shall be dated following the date of the new securities (such part of such calendar year being hereinafter included within the term calendar year). Available net income for each such calendar year shall be

determined by deducting all fixed charges of the reorganized company and its wholly owned railway subsidiaries accruing during such calendar year from the consolidated income of the reorganized company and its wholly owned subsidiaries available for fixed charges for such calendar year (determined in accordance with the applicable accounting rules, subject to the adjustments specified in the next succeeding paragraph). If any period for which available net income is to be determined precedes the consummation date, the consolidated railway operating revenues, and the consolidated income available for fixed charges, to be used for the ascertainment of available net income for such period shall be those of the bankruptcy trustees and their wholly owned railway subsidiaries for such period.

Available net income shall be ascertained for each calendar year, as the accounts shall be stated on the books of the reorganized company when its accounts are closed for such calendar year, without adjustments, except that (1) no amounts shall be charged to operating expenses for retirements of nondepreciable property, (2) any adjustment necessary to correct the income account for any prior year shall be made by appropriate entries which may either be made in the accounts of the current year and/or, in the discretion of the board of directors of the reorganized company, and subject to the approval of the Commission or such other governmental agency as may at the time have jurisdiction over the accounts of the reorganized company, may be made in whole or in part in the accounts of any subsequent year or years, and any such debits or credits to adjust income in prior years shall be treated as income items for the year in which entered on the books, whether cleared through income or profit and loss accounts and (3) if, in respect of any calendar year, the available net income (ascertained in all cases after the adjustments provided in this paragraph) is a deficit, the amount of such deficit shall be carried forward and be deducted in determining available net income for the succeeding calendar year or calendar years until such deficit (or accumulated or remaining deficits) be extinguished by earnings which, in the absence of such deficit or deficits, would be available net income.

Available net income for each calendar year shall be applied on the May 1 next following the end of such calendar year to the following purposes and in the following order:

(1) To provide for such appropriation for capital expenditures, not exceeding the excess of (*a*) $500,000 or 1 percent of consolidated railway operating revenues of the reorganized company and its wholly owned railway subsidiaries for such calendar year, whichever shall be greater, over (*b*) the special reserve fund balance as of the end of such calendar year, as the board of directors may, by resolution adopted by the affirmative vote of two-thirds of the entire board, determine to be unavailable from other sources, and necessary to provide for capital expenditures in such calendar year or the next succeeding calendar year which, in the opinion of the board of directors, are essential for the safe operation of the properties of the reorganized company, or for the realization of customary standards of efficiency or economy in the operation of such properties.

(2) To the payment of all sinking-fund installments payable for any first-mortgage bonds, including the emergency-bond sinking fund, if then payable, such payments to be made equally and ratably except

to the extent that, as hereinabove provided, sinking funds for series other than series A shall have been subordinated.

(3) To the payment of interest on the then outstanding second-mortgage bonds (not including any thereof held in any sinking fund), and any accumulations thereof. No interest need be paid if it would amount to less than one-quarter of 1 percent. Any excess available for such interest, but not paid because of the last preceding sentence, shall be reserved and added to the income available for interest on the second-mortgage bonds for the next succeeding calendar year. In case more than one series of second-mortgage bonds is outstanding, and in any calendar year the amount available for the purposes specified in this subparagraph (3) is less than all interest (including unpaid accumulated interest) owing on all such bonds, the amount available shall be prorated among the several series in proportion to the respective interest rates thereon until second-mortgage bonds of each series shall have received an amount equal to 1 year's interest thereon, any then remaining balance to be prorated among the several series in proportion to the balance owing thereon respectively.

(4) To the payment of all sinking-fund installments payable for any second-mortgage bonds, such payments to be made equally and ratably except to the extent that, as hereinabove provided, sinking funds for series other than series A shall have been subordinated.

(5) To the payment of any interest required to be paid on second-mortgage bonds pursuant to the provisions of the paragraph hereinabove set forth relative to compensation for any reduction in interest payments on the second-mortgage bonds through utilization of subparagraph (1) of this series of subparagraphs.

(6) To any proper corporate purpose, including, if, when, and as declared by the board of directors of the reorganized company, the payment of dividends on the preferred stock and the common stock, subject to the relative rights of the two classes of stock, and to the provisions of the last paragraph hereinabove set forth relative to the special reserve fund.

If the date of the new securities shall be other than January 1, accruals of sinking-fund installments payable on May 1 of the next succeeding calendar year shall be computed on a proportionate basis.

Dividends may be paid on stock of either class, subject to the relative rights of the two classes of stock and to the provisions hereof for a special reserve fund, out of the income of any calendar year prior to the close of such calendar year if, but only if, prior to the declaration of such dividends, the board of directors shall have determined that the available net income for such year applicable for the purposes specified in the foregoing subparagraphs (1), (2), (3), (4), and (5) will be more than sufficient to pay the amounts payable out of such available net income pursuant to said subparagraphs, and such amounts shall have been deposited in trust for the purposes specified in said subparagraphs.

*Preferred stock.*—The amount of the new preferred stock to be originally authorized shall be fixed by the reorganization managers without limitation by the amount of the initial issue and there shall be issued upon reorganization an amount of preferred stock, series A, sufficient to carry out the plan. Additional preferred stock of any

series may, subject to the conditions hereinafter stated, be issued from time to time for any proper corporate purpose.

The new preferred stock, series A, shall be of the par value of $100 per share, and shall entitle the holders thereof in preference to the holders of the common stock to receive dividends, when and as declared by the board of directors, at the rate of 5 percent per annum out of the available net income for any calendar year. Dividends on the preferred stock, series A, shall be cumulative in respect of each calendar year, but only to the extent that available net income for such calendar year is applicable to dividends on the preferred stock, series A, under the provisions hereof (or would have been so applicable except for any deduction made from such available net income pursuant to subparagraphs (1) or (5) relative to the application of available net income), but is not distributed. If there are outstanding shares of preferred stock of different series of the same class, (*a*) the earnings of each calendar year applicable to dividends thereon shall, for the purpose of determining dividend accumulations, be apportioned among the respective series in proportion to the dividend rates on such series, respectively, and (*b*) all amounts paid in dividends on the preferred stock shall be prorated among the several series in proportion to the respective dividend rates thereon until preferred stock of each series shall have received an amount equal to 1 year's dividends thereon, and the balance of such dividends shall be prorated among the several series in proportion to the remaining accumulated unpaid dividends thereon, respectively. No dividend shall be paid on the common stock in any calendar year unless all accumulated unpaid dividends for all prior calendar years shall have been paid or declared and set apart for payment on the preferred stock, and, if the dividend on the common stock shall be payable out of available net income for the year in which payment is made, unless full dividends for such year at the stipulated dividend rate of the respective series shall also have been paid or declared and set apart for payment on the preferred stock.

In the event of the dissolution, winding up, or liquidation of the reorganized company, the holders of preferred stock, series A, shall be entitled to receive out of the assets of the reorganized company $100 per share, together with an amount equal to all accrued, unpaid, and accumulated dividends, before any distribution shall be made to the holders of common stock.

The preferred stock, series A, shall be redeemable in whole or in part at any time on 60 days' notice at its par value, plus an amount equal to dividends at the rate of 5 percent per annum, whether or not earned, from the beginning of the last preceding calendar year to the redemption date, less any dividends paid for that period, plus all accumulated dividends for preceding years. The holders of preferred stock, series A, shall have no preemptive right to subscribe to any shares of stock of any class or to securities convertible into stock of any class.

The preferred stock, series A, shall be convertible, at the option of the holder, at any time on or before 15 days prior to the date as of which such stock shall have been called for redemption, into common stock as at the time constituted, at the rate of two shares of common stock for one share of preferred stock.

The certificate of incorporation of the reorganized company shall provide in substance that the reorganized company shall not, without the vote or consent of the holders of at least two-thirds in par value of the outstanding preferred stock, series A, (*a*) amend the certificate of incorporation of the reorganized company or any certificate amendatory thereof or supplemental thereto so as to alter or change adversely the preferences and voting rights to which the holders of preferred stock, series A, are entitled thereunder, (*b*) create any additional stock ranking either as to assets or dividends in priority to or on a parity with the preferred stock, or (*c*) issue any of the shares of preferred stock which shall be originally authorized for any purpose other than to carry out the plan or to refund outstanding obligations or to provide for expenditures chargeable to capital account.

Holders of preferred stock shall be entitled to one vote a share on all matters, except that in elections of directors, which shall be by cumulative voting, each holder of stock of any class shall be entitled to as many votes a share as the number of directors for which the stock of such class has at the time the right to vote. Until regular dividends at the full rate borne by the preferred stock shall have been paid for 3 consecutive years on all outstanding preferred stock and thereafter, so long as there shall be any accumulated dividends on the preferred stock which shall have remained unpaid for 12 months after the close of the year in respect of which such dividends shall have accumulated, the holders of the preferred stock, voting as a class, shall be entitled to elect a majority of the directors of the reorganized company and the holders of the common stock, voting as a class, shall be entitled to elect the remaining directors. If, after the holders of the preferred stock shall have ceased to be entitled to elect a majority of the board of directors, (*a*) the reorganized company shall fail for 3 consecutive calendar years to pay full dividends on all preferred stock at the time outstanding or (*b*) accumulated unpaid dividends on the preferred stock of any series shall amount to 10 percent or more, the holders of the preferred stock shall again be entitled to elect a majority of the board of directors until full current dividends shall have been paid on the preferred stock for 3 consecutive years, and all dividends accumulated up to the end of the last preceding calendar year shall have been paid. Holders of the preferred stock, voting as a class, shall have the right to elect not less than two directors after default of the equivalent of six quarterly dividends.

Subject to the foregoing provisions relative to preferred stock, the certificate of incorporation will permit the authorization and issuance of additional preferred stock of such series and amounts, with such par value and entitled to such dividends, voting rights, priority, redemption, conversion, and other special privileges and restrictions as the board of directors may determine in its discretion.

*Common stock.*—The number of shares of common stock to be originally authorized shall be fixed by the reorganization managers without limitation by the amount of the initial issue, and there shall be issued upon reorganization a number of shares of common stock sufficient to carry out the plan. All the common stock shall be without

par value. The necessary number of shares of common stock shall be reserved for conversion of the second-mortgage bonds, series A, and the preferred stock, series A, to be issued under the plan.

Holders of common stock shall be entitled to one vote a share on all matters except that (*a*) directors shall be elected by cumulative voting as aforesaid and (*b*) holders of preferred stock may be entitled to elect stated proportions of the board of directors by separate class vote as provided above.

So far as permitted by law, any vote or consent by the holders of common stock authorizing the issuance of additional shares of stock of any class or of securities convertible into stock of any class may waive, on such terms and conditions, if any, as may be specified in such vote or consent, the preemptive right of all the holders of shares of common stock to subscribe to such additional shares or securities.

## TREATMENT OF EXISTING SECURITIES AND CLAIMS

Holders of outstanding bonds of the several classes shall receive, respectively for each $1,000 principal amount thereof, cash and new securities approximately in the amounts specified below (the amounts of cash specified being herein called the cash allocations):

| Old securities | Cash allocations | New securities to be issued | | | |
|---|---|---|---|---|---|
| | | First mortgage 4's | Income 4½'s | Preferred stock | Common stock of no-par value stated at $50 a share |
| Fort Scott | $61.34 | $733 | $267 | | |
| Prior lien, series A | 15.36 | 219 | 171 | $332 | $333.50 |
| Prior lien, series B | 25.39 | 233 | 182 | 353 | 355.00 |
| Consolidated, series A | 21.05 | 221 | 158 | 174 | 174.00 |
| Consolidated, series B | 36.22 | 243 | 174 | 191 | 191.50 |

The new securities may be issued in temporary form in the first instance or interim certificates may be issued therefor. Scrip may be issued and distributed in lieu of fractions of a bond or share of stock. Such scrip shall be nondividend bearing or non-interest-bearing and nonvoting, but shall be exchangeable within 5 years after the consummation date for new securities (or interim certificates therefor) when presented in proper multiples upon terms and conditions approved by the reorganization managers.

The bank creditors or their transferees shall receive, respectively, cash and new securities approximately in the amounts specified below, being the cash and new securities allocable to the collateral held by them, respectively:

| | Cash allocations | New securities to be issued | | | |
|---|---|---|---|---|---|
| | | First mortgage 4's | Income 4½'s | Preferred stock | Common stock of no-par value stated at $50 a share |
| Chase National Bank | $151,526.37 | $1,016,590.50 | $727,929 | $799,048.50 | $801,140.00 |
| Guaranty Trust Company | 56,593.75 | 379,687.50 | 271,875 | 298,437.50 | 299,219.00 |
| Bankers Trust Co | 22,637.50 | 151,875.00 | 108,750 | 119,375.00 | 119,687.50 |
| Central Hanover Bank and Trust Co | 22,637.50 | 151,875.00 | 108,750 | 119,375.00 | 119,687.50 |
| First National Bank in St. Louis | 22,637.50 | 151,875.00 | 108,750 | 119,375.00 | 119,687.50 |
| Mercantile Commerce Bank & Trust Co | 22,637.50 | 151,875.00 | 108,750 | 119,375.00 | 119,687.50 |

Nothing in the plan shall restrict the right of the court to order distributions of available cash from time to time before the consummation date or shall limit the amount of any such distributions. All such distributions shall be divided as follows: For each $1,000,000 of distribution, the following amounts shall be paid per $1,000 bond: On the Fort Scott bonds, $10.01; on the prior-lien bonds, series A, $2.88, on the prior-lien bonds, series B, $3.07; on the consolidated bonds, series A, $3.10; and on the consolidated bonds, series B, $3.41.

Cash so paid shall be credited against the cash allocations payable under the plan. For each amount of $1,000,000 in which the aggregate of such payments on the Fort Scott bonds outstanding and pledged shall exceed the aggregate of the cash allocations payable on such Fort Scott bonds under the plan, plus interest accruing on the unpaid principal of such Fort Scott bonds at 4 percent per annum from December 31, 1943, to the date of the new securities, the following changes shall be made in the allotment of income bonds per $1,000 bond of the existing issues.

| Issue | Increase | Decrease |
|---|---|---|
| Fort Scott bonds | | $21.05 |
| Prior-lien series A bonds | $5.24 | |
| Prior-lien series B bonds | 5.87 | |
| Consolidated series A bonds | | .62 |
| Consolidated series B bonds | | .68 |

Allocations of new securities, other than income bonds, shall not be changed because of any cash distributions or reallocations of income bonds made pursuant to these provisions.

Subject to the foregoing provisions, such distributions shall be credited against claims and taken into account in such manner as the reorganization managers may determine with the approval of the court.

The interests or equities of (1) general creditors, of the debtor, (2) holders of preferred stock of the debtor, (3) holders of common stock of the debtor, and (4) holders of claims against the debtor entitled to priority or preference over the claims of general creditors, but not over any one or more of the mortgages, have no value, and nothing shall be distributable to them.

*Claims not affected by the plan.*—The equipment obligations of the debtor and of the bankruptcy trustees, outstanding upon consummation of the plan, shall remain undisturbed, and shall be assumed by the reorganized company. The interests of the holders of such obligations will not be adversely and materially affected by the plan.

Claims against the debtor entitled to priority over the respective mortgages and claims, current liabilities, and obligations incurred by the bankruptcy trustees during the reorganization proceedings, or by the receiver or receivers appointed by the court in the proceedings begun on November 1, 1932, to the extent unpaid at the date of consummation of the plan, shall be paid in cash or assumed by the reorganized company (subject to any applicable statutes of limitations). All such claims, liabilities, and obligations may be paid and discharged by the reorganized company, or may be adjusted or compromised and dealt with in such manner as may be determined by the board of directors of the reorganized company, subject to the approval of the court. The interests of the holders of such claims, liabilities, and obligations will not be adversely and materially affected by the plan.

The reorganized company shall assume liability for and shall pay in full, in due course, any and all taxes due to the United States from the debtor or from the bankruptcy trustees subject to the statutes of limitations normally applicable to the assessment and collection of such taxes, without requiring proof in the reorganization proceeding of any such taxes; provided, however, that the liability of the reorganized company for any taxes which are the subject of litigation on the date of confirmation of the plan, or which may become the subject of litigation on any date thereafter and prior to the expiration of the applicable statutes of limitations, shall be determined pursuant to law, and provided, further, that this provision shall not be deemed to preclude the debtor, the bankruptcy trustees, or the reorganized company from contesting the merits of any such tax claim in the manner provided by law. The interest of the United States as the holder of such tax claim will not be adversely and materially affected by the plan.

The expenses of reorganization, as allowed by the court, subject to the provisions of section 77 of the Bankruptcy Act, shall be paid in cash. The interests of the holders of claims for such expenses of reorganization will not be adversely and materially affected by the plan.

All contracts made by the bankruptcy trustees pursuant to their duties as such trustees, and not fully performed, and all executory contracts made by the debtor and not disaffirmed by the bankruptcy trustees prior to the consummation date, shall be assumed by the reorganized company. The interests of the other parties to such contracts will not be adversely and materially affected by the plan.

Since the holders of 100 shares of preferred stock of the Kansas City, Fort Scott and Memphis Railway Company (hereinafter called the Fort Scott Company) not owned by the debtor have not procured a judgment of the court determining their rights, as required by the opinion of the court dated July 25, 1942, no provision can be made herein for such stockholders. If such stockholders shall be held to be not barred from assertion of their claims by the lapse of time, and

shall establish any claim against the debtor which the court shall determine to be secured by a lien or charge ahead of, or to be entitled to priority over the prior-lien mortgage, the court may direct the reorganized company to issue to such stockholders such securities, or, to pay to such stockholders such amount in cash, as, in the opinion of the court will fairly represent their relative rights in respect of such claim. In view of these provisions the interests, if any, of the holders of said preferred stock of the Fort Scott Company will not be adversely and materially affected by the plan. If such stockholders shall fail to establish a claim, the interest or equity of such holders has no value, and nothing shall be distributable to them.

The debtor, as reorganized, or the transferee of the property of the debtor, in connection with any settlements of transportation accounts between the United States and the debtor or the reorganized company, shall be required to recognize and pay or allow for any and all sums, determined through audit, adjustment, compromise, or litigation, as due the United States by virtue of the provisions of section 322 of the Transportation Act of 1940, 54 Stat. L. 955, for overpayments made prior to the date of confirmation of a plan of reorganization, without requiring proof thereof in this reorganization proceeding and without prejudice by reason of such sums not having been proved herein, with the same relative priority as they now have with respect to other obligations of the debtor. The interests of the United States as the holder of such claims will not be adversely and materially affected by the plan.

*Voting trust.*—A voting trust shall be created in order to assure a stable, experienced, and impartial management during the transition period which will follow the consummation of the reorganization and the termination of the war. All of the preferred stock, series A, and the common stock of the reorganized company, issued in the reorganization, and all other voting stock thereafter issued by the reorganized company during the continuance of said voting trust shall be deposited in said voting trust, and voting-trust certificates will be issued therefor. All references in the plan to stock of the reorganized company shall, unless the context otherwise requires, be deemed to mean voting-trust certificates for such stock.

The voting trustees shall be three in number. One voting trustee shall be designated by the committee for the prior-lien mortgage bonds of the debtor (hereinafter called the prior-lien committee) and one by the committee for the consolidated-mortgage bonds of the debtor (hereinafter called the consolidated committee), both subject to the approval of the court, and one voting trustee shall be designated by the court; provided, however, that if the court shall find that at the time of designation any of the committees has ceased to hold or to represent a substantial interest in the property, the court may, in its discretion, designate, in lieu of such committee. Such voting trust shall continue for 5 years from the consummation date. The voting-trust agreement shall provide that, if any vacancy shall occur among the voting trustees, such vacancies shall be filled by the remaining voting trustee or voting trustees.

*Board of directors.*—The board of directors of the reorganized company shall consist of not less than 11 and not more than 17 members. The members of the first board of directors shall be designated by the

reorganization managers with the approval of the court; provided, however, that if the court shall disapprove any person or persons designated by the reorganization managers as a member of the board of directors, the court, in the absence of a designation by the reorganization managers that is acceptable to the court, may itself designate a member or members of the board of directors in lieu of such person or persons so disapproved. Thereafter, the directors shall be elected annually by the voting trustees so long as the voting trust shall continue in effect, and thereafter by the stockholders.

*Reorganization managers.*—There shall be four reorganization managers, of whom one shall be designated by the committee for the Fort Scott refunding-mortgage bonds, one by the prior-lien committee, and one by the consolidated committee, all subject to the approval of the court, and one by the court; provided, however, that if the court shall find that at time of designation any of the committees has ceased to hold or to represent a substantial interest in the property, the court may in its discretion designate in lieu of such committee. Should any of the parties named fail to make such designation within such time after confirmation of the plan and notice as the court shall consider reasonable, the court shall appoint the reorganization manager whom such party was entitled to designate. If there be any vacancy, however created, after the appointments are made, the successor reorganization manager shall be appointed by the party or parties who designated the reorganization manager whose position has become vacant, subject to the approval of the court, or, as the case may be, by the court. In case of failure of any party to designate any such successor within such time as the court shall consider reasonable, such successor shall be designated by the court.

Subject to any limitations of law, the reorganization managers shall have full discretionary power (*a*) to take all such action and to enter into such arrangements, financial and otherwise, as they may deem necessary or advisable in order to consummate and carry into execution the plan; (*b*) to fix the compensation of trustees, depositaries, counsel and others whose services they may employ in the execution of their powers and of the voting trustees, which, together with their reasonable expenses, including counsel fees, shall be paid by the reorganized company; (*c*) to incorporate the reorganized company (if it be deemed necessary or desirable to form a new corporation) or to amend the certificate of incorporation of the debtor, to supervise the transfer of any properties to the reorganized company and to make agreements and commitments for its account; (*d*) to provide the method by which creditors and other interested parties may participate in the plan; and (*e*) to determine the form and provisions (so far as not otherwise specifically provided in the plan) of the certificate of incorporation or amendment thereto of the reorganized company, its bylaws, the new bonds, and the mortgages under which the same shall be issued, the voting-trust agreement and certificates, the stock certificates, scrip, interim certificates, and any other instruments deemed by the reorganization managers to be necessary or proper in connection with the plan; (*f*) to make such minor adjustments in details of the plan as they may deem advisable; and (*g*) to construe the plan. Any construction of the plan approved by the reorganization managers on

advice of counsel shall, subject to approval by the court, be conclusive. With the approval of the court, the reorganization managers may make such changes in the allotment of new securities as may be necessary to avoid the issue of scrip in excessively small denominations. The reorganization managers, however, shall exercise only such powers as shall be necessary to carry out the plan in accordance with its provisions, subject to the direction of the court, and the court shall approve the form of the certificate of incorporation or amendments thereto, bylaws, mortgages, bonds, coupons, stock certificates, voting-trust certificates, scrip, and interim certificates before they are put in use. The reorganization managers may act by a majority of the reorganization managers as from time to time constituted, at a meeting or in writing without a meeting, may employ such agents, attorneys, and others as they may deem desirable to carry out the plan, and may delegate to others any power or discretion conferred upon them, and no reorganization manager shall be liable for any action taken by him in good faith or by any person employed by the reorganization managers, except for his individual malfeasance or willful neglect. The mortgage trustees, transfer agents, and registrars of the new securities, and such depositaries as may be necessary in connection with the distribution thereof, shall be appointed by the reorganization managers.

Nothing herein contained shall be construed as authorizing the reorganization managers to solicit deposits of securities or authorizations to represent security holders, except upon approval by the Commission of the terms of such solicitation by further action pursuant to Section 77 (p) of the Bankruptcy Act, as amended.

*Miscellaneous provisions of mortgages, et cetera.*—Each of the mortgages, certificates of incorporation, and other instruments herein provided for shall contain such provisions, in addition to those herein specified (including, without limitation, provisions for releases of mortgaged property), as the reorganization managers may deem necessary or proper, and as may be approved, where required hereby or by law, by the Court.

In the event that the reorganized company shall be merged or consolidated or unified with any other class 1 railroad, whether or not a subsidiary of the reorganized company, then by vote or consent of the holders of a majority in par value of the preferred stock and a majority of the shares of common stock then outstanding, procedural provision may be made for ascertaining available net income without the maintenance of separate books of account, and such provision shall be binding on all holders of stock of such classes.

The new first mortgage and the new second mortgage may contain such provisions as the reorganization managers may approve either (1) permitting the reorganized company, while it is not in default in the performance of its obligations under said mortgages respectively and during any period of grace therein specified, to use and dispose of, to the same extent as if not subject to the lien of such mortgages respectively, cash, temporary cash investments, tools, supplies, and other current items or (2) excluding such property from the liens of said mortgages.

*Funds on deposit with mortgage trustees.*—Upon consummation of the plan, all funds (except funds deposited with Old Colony Trust

Company or its depositary for the payment of principal and interest on the general-mortgage bonds and income-mortgage bonds of the Kansas City, Memphis & Birmingham Railroad Company, and funds deposited for payment, or funds or securities deposited as indemnity in respect of the obligations referred to in the following paragraph) on deposit with the trustees under mortgages on the property acquired or to be acquired by the reorganized company (other than the mortgages created pursuant to the plan) and all collateral pledged under such mortgages shall be surrendered to the reorganization managers for delivery to the treasury of the reorganized company or for cancelation as hereinbefore provided.

*Payment of unpresented securities and coupons.*—The bankruptcy trustees or the reorganized company shall pay, upon presentation and surrender, (1) all securities issued by the bankruptcy trustees or by the debtor which shall have become due and payable prior to the consummation date, and shall not have been paid solely because of failure of presentation for payment (including any of such securities issuable in exchange for securities of St. Louis and San Francisco Railroad Company not yet exchanged under the plan and agreement of reorganization dated November 1, 1915), and any unpaid coupons appurtenant to any such securities, (2) $1,000, principal amount, trust-mortgage 5-percent bond, due 1987, of St. Louis and San Francisco Railway Company, and appurtenant coupons, (3) all coupons matured prior to November 1, 1932 appurtenant to Fort Scott bonds, prior lien bonds, and consolidated bonds outstanding in the hands of the public (excluding pledged bonds) and (4) all coupons or portions thereof that the court shall, before consummation of the plan, have ordered to be paid, whether before January 1, 1944, or, subject to the provisions hereinabove set forth relative to cash distributions before the consummation date, on or after January 1, 1944; provided, however, that each such security or coupon (other than said trust bond of St. Louis and San Francisco Railway Company and coupons appurtenant thereto) shall be presented for payment within 6 years after the consummation date, and all such securities or coupons (other than as aforesaid) not presented for payment within such period shall become void, and all funds then remaining on deposit for the payment thereof shall be paid to the reorganized company.

*Executing the plan by sales.*—If so ordered by the court, the plan, after it shall have been found fair and equitable, and shall have been confirmed by the court, may be executed by a sale or sales, at not less than fair upset prices to be fixed by the court, of all or any part of the property of the debtor, on such conditions, including the extent to which the sale may be free of liens or subject to prior liens or interests, and in such manner, as the court may direct. Upon any such sale or sales, the property and assets offered for sale may be purchased for the benefit of the reorganized company by the reorganization managers, and in that event there shall be applied on account of the purchase price the distributive share of the proceeds of such sale of all securities, the holders of which shall have assented to the plan, and of the securities, though not assenting to the plan, of all classes the holders of two-thirds of the voted claims in which shall have accepted the plan. If the property of the debtor so offered for sale should be

sold to others than the reorganization managers, the plan (other than the foregoing provisions of this paragraph) shall be inoperative.

In the event of any such sale to the reorganization managers, the reorganization managers may in their discretion sell all or any portion of the new securities distributable under the plan in respect of securities of any bondholder, if neither such bondholder nor two-thirds of the voted claims in the class to which such bondholder belongs shall have accepted the plan; provided, however, that any bondholder of a class the holders of two-thirds of the voted claims in which shall not have accepted the plan, who shall not himself have accepted the plan, shall have the right, if he shall so notify the reorganization managers within a period of 30 days after the confirmation of such sale, to assent to the plan and receive the securities allocated to him under the plan in lieu of his aliquot share of the proceeds of such sale. The proceeds of such sale of securities, together with any other funds which, in the judgment of the reorganization managers, are available among the assets of the debtor's estate or of the reorganized company, may be used to pay the portion of the purchase price payable in cash on any such sale of properties of the debtor.

Upon any such sale, nonassenting creditors of any class the holders of two-thirds of the voted claims in which shall not have accepted the plan in accordance with the provisions of section 77, and/or the stockholders of either class shall be entitled to receive, in lieu of the securities, if any, otherwise issuable under the plan, their equitable proportion of the proceeds of such sale, after deducting therefrom all expenses of such sale and the amount which would be required to pay in full, to all creditors whose claims equitably marshaled are prior in lien or superior in equity to the claims of such nonassenting creditors or the rights of such stockholders, the principal of their claims and all unpaid interest accrued thereon to the date of such sale.

*Effect of accepting the plan.*—Acceptance of the plan shall include acceptance of the provisions of the new bonds, mortgages, stock certificates, certificate of incorporation or amendments thereto, voting-trust certificates, and all instruments necessary or appropriate to the carrying out of the plan, other than the orders of the court and the Commission, to the same effect as though the terms of such instruments were set forth in full herein.

*Construction of plan.*—The construction of the plan by the court, whether before or after the submission of the plan to creditors, shall be final and conclusive. The court, whether before or after submission, may cure any defect, supply any omission, or reconcile any inconsistency, in such manner or to such extent as may be necessary or expedient in order to carry out the plan effectively.

The carrying out of the plan shall be as provided in the Bankruptcy Act as at the time in effect.

## Additional Clauses from Commission's Order of July 4, 1944

In addition to the provisions of the plan approved hereinbefore shown, the Commission's order approving the plan also ordered—

(1) That the authorization and approval herein granted by this Commission are upon the condition that the journal entries covering the

necessary accounting adjustments under the order will be submitted to this Commission for approval before they are recorded on the books of the reorganized company under the plan of reorganization herein approved.

(2) That nothing herein contained shall be, or be construed as, a grant of authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation, or merger of the debtor's properties, or pooling of traffic, pursuant to either the Bankruptcy Act or the Interstate Commerce Act, until further action by this Commission upon confirmation of the plan by the court.

(3) That except as thus modified, the terms and conditions of said prior orders of July 6 and November 16, 1940, shall be, and remain, in full force and effect.

# INTERSTATE COMMERCE COMMISSION

FINANCE DOCKET NO. 10008

## ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY REORGANIZATION

*Submitted November 20, 1939. Decided July 6, 1940*

Plan of reorganization for the St. Louis-San Francisco Railway Company, pursuant to section 77 of the Bankruptcy Act, as amended, approved.[1]

*William V. Hodges, Jesse McDonald, Martin Jacobs,* and *William V. Hodges, Jr.,* for debtor.

*Henry B. Day, Albert Hale, Eph A. Karelsen, Frederick Baum, Edwin S. S. Sunderland, Thomas O'G. FitzGibbon, George J. Miller, Henry W. Anderson, George D. Gibson, Robert T. Swaine, Leonard D. Adkins, Littleton Groom, Cassius M. Clay, Florence de Haas Dembitz, Frederick E. Baukhages, III, D. Willard, Jr., William J. Kane, E. G. Buckland, Jack Louis Kraus, II, Fitzhugh McGrew, Ripley L. Dana, Charles J. Winkler, Jr., Frederick M. Dearborn, Jr., A. M. Lewis, Hovey C. Clark, Curtis Heath, M. Barratt Walker, Orville W. Wood, Joseph M. Hartfield, Carl E. Newton, George W. Martin, A. A. Berle, Jr., James B. Alley, W. Meade Fletcher, Jr., Fred N. Oliver, John C. Donnally, DeCoursey Fales, Merrill M. Manning, C. S. Bates, Haughton Bell, Sterling Pierson, Alfred H. Meyers, Ross McLeod, Victor House, J. Kemp Bartlett, Alfred N. Heuston, Edward H. Stiefel, Albert L. Reed,* and *H. Vincent Smart* for interveners.

*Chester I. Long, Samuel W. McIntosh, Jerome J. Shuman, Lawrence Cake, Harold J. Gallagher,* and *Alexander B. Royce* for other interested parties.

REPORT OF THE COMMISSION

DIVISION 4, COMMISSIONERS PORTER, MAHAFFIE, AND MILLER

BY DIVISION 4:

Exceptions to the report proposed by the examiners were filed, and the case was argued orally before us.

## I. GENERAL

### A. NATURE OF PROCEEDINGS; HEARINGS; INTERVENERS

The St. Louis-San Francisco Railway Company, a Missouri corporation, hereinafter called the debtor, for the purpose of effecting a reorganization under section 77 of the Bankruptcy Act, as amended,

[1] Prior reports, 207 I. C. C. 623, 221 I. C. C. 199 and 251, 224 I. C. C. 29, 228 I. C. C. 73, and 233 I. C. C. 627 and 780.

in proceedings entitled "In the Matter of St. Louis-San Francisco Railway Company, a Corporation, in Proceedings for the Reorganization of a Railroad, No. 7004—1", then and now pending in the District Court of the United States for the Eastern District of Missouri, Eastern Division, on November 24, 1937,[2] filed with this Commission for its approval a modified plan of reorganization. A hearing on this plan, pursuant to notice, was held by the Commission on February 8, 1938, and upon request of committees representing holders of bonds of the Kansas City, Fort Scott & Memphis Railway Company, hereinafter called the Fort Scott, and the debtor's prior-lien and consolidated bonds, the hearing was adjourned to May 3, 1938. The adjourned hearing was postponed from time to time. On October 21, 1938, the committees, pursuant to authority granted, filed a plan of reorganization with the Commission for its approval. The three committees urged the same provisions in most, but not in all, instances. Further hearings, pursuant to notice, were held by the Commission on November 1, 2, and 3, 1938. The committees' plan was supplemented at the hearing and modified on initial brief, complete agreement being finally reached by the proponents, such agreement being to the plan as an entirety, however, and not necessarily to any single provision apart from the plan as a whole. Further references herein to the committees' plan are to the plan in the form reached on initial brief. Plans generally conforming to the plan proposed by the examiners were subsequently filed by the committees, with their exceptions, showing the changes urged in event of an approval in general outline of the provisions of the examiners' plan. References hereinafter to matters urged by the committees at variance with the committees' plan are to matters thus urged conditionally in the conformed plans.

In addition to the committees which represented holders of the Fort Scott refunding-mortgage bonds, holders of the debtor's prior-lien bonds, and holders of the debtor's consolidated-mortgage bonds, hereinafter designated, respectively, the Fort Scott committee, the prior-lien committee, and the consolidated committee, the Reconstruction Finance Corporation and the Railroad Credit Corporation, hereinafter sometimes called, respectively, the Finance Corporation and the Credit Corporation, the trustees of the three mortgages mentioned, the trustee of the general mortgage of the Kansas City, Memphis & Birmingham Railroad Company, hereinafter called the Birmingham, a number of holders and representatives of holders of bonds issued under one of the several mortgages, and others intervened in the proceeding before the Commission. Each of the three protective committees for the bondholders represents in excess of 60

2 The debtor's petition, stating that it was unable to meet its debts as they matured and that it desired to effect a plan of reorganization under section 77 of the Bankruptcy Act, as amended, was filed with the court on May 16, 1933, the debtor having been in receivership since November 1, 1932. On May 27, 1933, the court entered an order approving the petition as properly filed. With the petition the debtor filed a plan of readjustment and, pursuant to notice, hearings on the plan were held by the Commission on July 18 and 19, 1933, and December 1, 1936, concluding on the latter date. The Commission, division 4, in its report herein, 221 I. C. C. 199, decided March 17, 1937, concluded that approval at that time of any plan of reorganization of the debtor should be refused, without prejudice to continuation of the proceedings, and entered an order to that effect.

percent of the part of the respective issues outstanding in the hands of the public. Several of the interveners, though not filing plans, submitted evidence, filed briefs, or were heard in oral argument. The positions taken by such interveners will be stated hereinafter following an outline of the plans submitted.

(Superseded matter is here omitted)

C. DESCRIPTION OF DEBTOR'S PROPERTY

The St. Louis-San Francisco lines comprise a system of railroads in the States of Missouri, Kansas, Texas, Oklahoma, Arkansas, Tennessee, Mississippi, Alabama, and Florida. Points served by the system include St. Louis, Springfield, and Kansas City, Mo.; Columbus and Wichita, Kans., Tulsa and Oklahoma City, Okla., Dallas, Fort Worth, and Quanah, Tex., Fort Smith and Blytheville, Ark., Memphis, Tenn., Tupelo, Miss., Birmingham, Ala., and Pensacola, Fla. As of December 31, 1936, the debtor owned 6,561.41 miles of track, operated 6,788.08 miles, and jointly owned and used 36.65 miles. The mileage operated includes 19.41, 37.78, 103.19, 38.98, and 19.09 miles leased from the Birmingham Belt Railroad Company, the Butler County Railroad Company, the Jonesboro, Lake City & Eastern Railroad Company, the Miami Mineral Belt Railroad Company, and the St. Louis, Kennett & Southeastern Railroad Company, respectively. The Birmingham Belt Railroad Company is an operating company, and the other four are lessors only. The securities of all five are all owned by the debtor. System lines operated separately are the Birmingham Belt Railroad Company, which, in addition to the tracks leased to the debtor, owned 24.99 miles of yard tracks and sidings and operated 27.62 miles, and the following lines in the State of Texas: Quanah, Acme & Pacific Railway Company, owning 128.82 miles and operating 141.51 miles; and St. Louis, San Francisco & Texas Railway Company, hereinafter called the Texas company, owning 158.71 miles, operating 266.76 miles, and jointly owning and using 0.22 mile. Included in the latter operated mileage are 107.27 miles of the Gulf, Texas & Western Railway Company, a nonoperating company, the properties of which were leased July 1, 1930, to the Texas company and the securities of which are all owned by the debtor. The latter lessor company was granted a certificate on June 16, 1939, permitting abandonment of its line. *Gulf, T. & W. Ry. Co. Abandonment*, 233 I. C. C. 321. The debtor formerly owned all the capital stock and first-mortgage bonds of the Fort Worth & Rio Grande Railway Company, which owned 221.68 miles of main and branch line tracks in Texas. This property, with the exception of terminals at Fort Worth and certain cattle traps, was sold March 1, 1937, to the Atchison, Topeka & Santa Fe Railway Company, pursuant to authority granted by division 4 on December 31, 1936, in *Fort Worth & R. G. Ry. Co. Control and Operation*, 217 I. C. C. 659. The terminals and cattle traps mentioned were sold to the Texas company.

As of December 31, 1936, the debtor thus owned directly or controlled through ownership of all securities a total of 7,199.65 miles of track and operated a total of 7,260.84 miles, including 36.87 miles of

track jointly owned and operated. This mileage does not include the mileage of the Fort Worth & Rio Grande Railway Company. Of the mileage owned and controlled, 5,242.08 miles were first main track and 139.65 were second main track. Since the date shown, we have issued certificates permitting the abandonment of approximately 115 miles of the debtor's branch lines and connecting tracks. *St. Louis-S. F. Ry. Co. Abandonment*, 221 I. C. C. 241, *St. Louis S. W. Ry. Co. Abandonment*, 224 I. C. C. 639, *St. Louis-S. F. Ry. Co. Trustees Abandonment of Operation*, 228 I. C. C. 271, and *St. Louis-S. F. Ry. Co. Trustees Abandonment*, 228 I. C. C. 795, 233 I. C. C. 665, and 236 I. C. C. 792. On the other hand, approximately 13.8 miles of additional line were acquired. *St. Louis-S. F. Ry. Co. Trustees Purchase*, 239 I. C. C. 165.

The debtor owns all the securities of the Arkansas Mining & Coal Company, Frisco Construction Company, and Frisco Refrigerator Line, and approximately 49 and 51 percent of the securities of the Crawford County Mining Company and the New Mexico & Arizona Land Company, respectively. All of these are active nonrailroad companies. The debtor also owns all or the majority of the securities of 10 inactive railroad corporations,[3] and has an interest in 7 active operating railroad terminal companies.[4] The debtor owns all the outstanding securities, except directors' qualifying shares, of its wholly owned system lines.[5] The debtor uses 12.3 miles of line and the St. Louis, San Francisco & Texas 70.12 miles of line under trackage agreements. The system is in good physical condition, and no funds will be required for rehabilitation. There is no accrued depreciation or deferred maintenance of way and structures, except $1,287,481 accrued on the Arkansas & Memphis Railway Bridge & Terminal Company.

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[3] Kansas City & Memphis Railway & Bridge Company; Kansas City, Clinton & Springfield Railway Company; Kansas City, Fort Scott & Memphis Railway Company; Kansas City, Memphis & Birmingham Railroad Company; Metropolitan Rapid Transit, Light & Power Company; the Muscle Shoals, Birmingham & Pensacola Railroad Company; Railway Construction & Improvement Company; Red River, Texas & Southern Railway Company; Sapulpa & Oil Field Railroad; and the West Tulsa Belt Railway Company.

[4] Birmingham Terminal Company, Kansas City Terminal Railway Company, Rock Island-Frisco Terminal Railway Company, Terminal Railroad Association of St. Louis, Tulsa Union Depot Company, Union Terminal Company (Dallas, Tex.), and the Wichita Union Terminal Railway Company.

[5] These lines and the securities of each owned by the debtor are as follows: St. Louis, San Francisco & Texas Railway Company first-mortgage 4-percent bonds due January 1, 1930, but extended subject to demand by trustees of the prior-lien mortgage of the debtor, $200,000, capital stock $975,000; Paris & Great Northern Railroad Company first-mortgage 5-percent bonds due October 1, 1987, $339,000; Blackwell, Enid & Texas Railway Company first-mortgage bonds due January 1, 1934, $173,000; Red River, Texas & Southern Railway Company first-mortgage 4-percent bonds due March 1, 1933, $815,000, capital stock $400,000; Gulf, Texas & Western Railway Company first-mortgage 5-percent bonds due November 1, 1939, $2,000,000, capital stock $500,000; Quanah, Acme & Pacific Railway Company first-mortgage 6-percent bonds due October 1, 1939, $2,915,000, capital stock $150,000; Butler County Railroad Company capital stock $200,000; Miami Mineral Belt Railroad Company capital stock $200,000; Jonesboro, Lake City & Eastern Railroad Company first-mortgage 5-percent bonds due September 1, 1925, $674,000, capital stock $600,000; St. Louis, Kennett & Southeastern Railroad Company refunding and improvement mortgage 6-percent bonds due March 1, 1934, $150,000, capital stock $300,000; Birmingham Belt Railroad Company first-mortgage 4-percent bonds due October 1, 1922, $982,000, capital stock $50,000; total, par value, $11,623,000; total, book value, $12,550,525.

D. PRESENT CAPITALIZATION

The debtor's total capitalization as of December 31, 1937, was $391,634,843, comprising $114,711,526 of capital stock, $234,547,597 of funded debt unmatured, and $42,375,720 of funded debt matured unpaid. The long-term debt securities of the system companies outstanding in the hands of the public as of August 31, 1938, were in principal amount as follows:

| | |
|---|---|
| St. Louis-San Francisco Ry. Co.: | |
| Equipment obligations | $ 7,331,000 |
| Collateral-trust mortgage 5-percent bonds of 1887 | 4,000 |
| Prior-lien mortgage 4-percent bonds, series A, due July 1, 1950 | 91,887,097 |
| Prior-lien mortgage 5-percent bonds, series B, due July 1, 1950 | 25,561,500 |
| Consolidated-mortgage 4½-percent bonds, series A, due Mar. 1, 1978 | 108,305,000 |
| Consolidated-mortgage 6-percent bonds, series B, due June 1, 1936 | 10,000,000 |
| Kansas City, Memphis & Birmingham R. R. Co. general-mortgage 4-percent bonds due Mar. 1, 1934 | 3,323,390 |
| Kansas City, Memphis & Birmingham R. R. Co. 5-percent income bonds due Mar. 1, 1934 | 3,182,780 |
| Kansas City, Fort Scott & Memphis Ry. Co. refunding-mortgage 4-percent bonds due Oct. 1, 1936 | 25,835,000 |
| Total | 275,429,767 |

The short-term notes, obligations of the debtor, were as follows:

| | |
|---|---|
| Loan from Mercantile-Commerce Bank & Trust Co., St. Louis, Mo., due July 1, 1932 | $ 402,113 |
| Loan from Guaranty Trust Co., New York, N. Y., due July 1, 1932 | 1,042,894 |
| Loan from First National Bank, St. Louis, Mo., due July 1, 1932 | 342,984 |
| Loan from Bankers Trust Co., New York, N. Y., due July 1, 1932 | 422,811 |
| Loan from Central Hanover Bank & Trust Co., New York, N. Y., due July 1, 1932 | 433,469 |
| Loan from Chase National Bank, New York, N. Y., due Dec. 31, 1932 | 2,492,592 |
| Loan from Railroad Credit Corporation, due Dec. 31, 1933 | 3,307,432 |
| Loan from Reconstruction Finance Corporation, due on demand | 5,190,000 |
| Total | 13,634,295 |

The capital stock was as follows:

| | |
|---|---|
| St. Louis-San Francisco Ry. Co.: | |
| Preferred stock, 6-percent noncumulative[1] | $ 49,158,300 |
| Common stock | 65,543,226 |
| Kansas City, Fort Scott & Memphis Ry. Co. preferred stock, 4-percent noncumulative | 10,000 |
| Total | 114,711,526 |

[1] Preferred as to dividends, but not as to assets.

Interest is in arrears on all obligations except the equipment obligations, the Birmingham general-mortgage bonds and income bonds, and the collateral-trust bonds of 1887. Interest matured and unpaid on the Fort Scott bonds as of August 31, 1938, was $4,733,440; on the prior-lien bonds, series A and B, $22,052,903 and $7,668,450, respectively; on the consolidated bonds, series A and B, $29,242,350 and $3,600,000, respectively; and on the short-term notes $3,959,391; a total of $71,256,534. A part of this interest has since been paid.

Guaranties outstanding other than in intrasystem account are for securities of jointly controlled terminal companies.

### E. PROPOSED PLANS OF REORGANIZATION

1. *Capitalization and new securities.*—(*a*) *Debtor's plan.*—Under the debtor's plan, the equipment-trust certificates totaling $7,331,000 as of August 31, 1938, and the Birmingham general-mortgage and income bonds totaling $6,506,170, would be left undisturbed, except that the maturity date of the bonds would be extended to March 1, 1954. In exchange for the other securities of the debtor outstanding in the hands of the public there would be newly created and presently issued $86,720,000 of series-A first-mortgage bonds, $61,309,600 of series-A income bonds, $50,487,800 of prior-preferred stock, 294,944 shares of 5-percent preferred stock without par value, and 1,452,062 shares of common stock without par value. The capitalization proposed under this plan, including no-par stock at $100 a share, approximates $387,055,170 as of August 31, 1938.

The new first-mortgage bonds would be secured by a first lien, subject to the equipment-trust liens and liens of the Birmingham general-mortgage and income bonds on all property of the reorganized company, and, subject to certain exceptions, on after-acquired property. The series-A bonds would be dated January 1, 1938, would bear interest at the rate of 3¾ percent per annum, payable semiannually, would be subject to redemption at any time prior to maturity, and would mature December 31, 1978. The new first mortgage would provide for the issue of additional bonds of other series to an unlimited amount for various purposes and subject to various restrictions.

The new income bonds would be secured by a lien upon all property and assets which should at any time be subject to the new first mortgage, subject only to the prior lien of the first mortgage and any liens prior thereto. The series-A bonds would be dated January 1,

1938, would bear interest, noncumulative, at the rate of 4 percent per annum, payable annually if earned, would be subject to redemption at any time prior to maturity, would be entitled to the benefit of a sinking fund, and would mature December 31, 1988. The new income mortgage would also provide for the issue of additional bonds of other series to an unlimited amount for various purposes and subject to various restrictions.

If in any calendar year the reorganized company should fail to earn its fixed charges, such deficit would be added to the fixed charges in the next succeeding year or years, so that no income would be thereafter available for income bonds of any series until such deficit should have been made up. Interest on all income bonds would be payable in multiples of one-fourth of 1 percent. The indenture under which the first-mortgage and income-mortgage bonds would be issued would contain provisions to avoid default in case any installment of interest or sinking-fund payments should become due before the plan is consummated.

The prior-preferred stock would have a par value of $100 a share and would entitle the holder thereof to dividends at the rate of $5 a share per annum, cumulative in multiples of 25 cents a share to the extent that net income should be available therefor and not paid, before any dividends should be declared or paid on preferred or common stock. Each share would entitle the holder thereof to 1 vote. The stock would be callable at $105 a share, together with all unpaid dividends declared thereon, and in the event of dissolution would be preferred over other classes of stock in the distribution of assets to the extent of $100 a share plus unpaid dividends declared or accumulated. In addition to the 504,878 shares required in reorganization under the debtor's plan, approximately 100,000 shares would be available for issue for any corporate purposes.

The preferred and common stock would be without par value, but would have a stated value of $100 a share, which could be changed by the board of directors with the approval of the court. Dividends on the preferred stock of $5 a share per annum would be cumulative in multiples of 25 cents a share to the extent that net income is available therefor and not paid. Each share would entitle the holder thereof to 1 vote. In the event of dissolution, the holder of each share of this stock would be entitled to the same share in the assets of the company as that to which a holder of common stock would be entitled. The preferred stock would be callable at $100 a share, together with all unpaid dividends declared or accumulated. Each share of common stock would entitle the holder thereof to 1 vote. In addition to the 294,944 shares of preferred stock required under the plan, there would be approximately 100,000 shares available for issue for any proper corporate purpose.

In addition to the 1,452,062 shares of common stock to be issued under the plan, there would be approximately 200,000 shares available for issue for any proper purpose.

(*b*) *Committees' plan.* — The plan of reorganization proposed by the bondholders' committees would leave undisturbed the equipment obligations, which as of January 1, 1940, would amount to $5,874,000. The plan contemplates the issue of $6,506,170 of new first-mortgage series-A bonds, $71,714,623 of new first-mortgage series-B bonds,

$50,482,355 of new income-mortgage series-A bonds, $77,307,713 of new preferred stock, 1,100,181 shares of new class-A common stock without par value, and 614,938 shares of new class-B common stock without par value. The total new capitalization would thus be $383,396,761, including no-par stock at $100 a share.

The new first-mortgage bonds would be unlimited in authorized amount, and would be secured by a first lien, subject to the liens upon equipment, on all the property and assets of the reorganized company and, subject to certain exceptions and limitations, on after-acquired property. The series-A bonds would be dated January 1, 1940, would bear interest at the rate of 4 percent per annum, payable semiannually, or such other rate as would be necessary to give them a market price, when the reorganization is consummated, approximately equal to their principal amount, would be subject to redemption at any time prior to maturity, would be convertible into a like principal amount of series-B bonds, and would mature January 1, 1950. The series-B bonds would be dated January 1, 1940, would bear interest at the rate of 4 percent per annum, would be subject to redemption at any time before maturity, and would mature January 1, 1980. In addition to the first-mortgage bonds to be issued in reorganization, $5,000,000 of series-B bonds would be placed in the treasury of the reorganized company for sale or pledge to provide for contingencies.

The new income-mortgage bonds would be unlimited in authorized amount, and would be secured by a lien, subject only to the lien of the first mortgage and liens prior thereto, upon all property at any time subject to the lien of that mortgage. The series-A bonds would be dated January 1, 1940, would bear interest, cumulative to a maximum amount of 22½ percent, but not beyond, at the rate of 4½ percent per annum, payable annually only out of available net income, after payment of fixed charges and deductions for capital fund and part one of the emergency-bond sinking fund, would be subject to redemption on May 1 in any year prior to maturity, would be entitled to the benefit of a sinking fund to be created out of available net income, would be convertible into common stock, class A, as at the time constituted, at any time on or before January 1, 1945, at the rate of 15 shares for each $1,000 of such bonds, and thereafter at the rate of 12½ shares for each $1,000, principal amount, of such bonds, and would mature January 1, 2015.

The preferred stock would have a par value of $100 a share and would be preferred over other issues of stock in the distribution of dividends and in case of liquidation or reorganization in the distribution of assets to the extent of its par value and accrued and unpaid accumulated dividends plus such premium as might be specified in the stock certificates. Each share would entitle the holder to cumulative voting in the election of directors and to one vote in all other matters, and under certain circumstances, the holders of the preferred stock voting as a class would be entitled to elect the majority of directors.

Preferred stock, series A, would be entitled to dividends at the rate of $5 per annum, cumulative to the extent earned in excess of sinking-fund and capital-fund requirements in any calendar year, but not paid. Accumulation of preferred-stock dividends would not be reduced by the capital fund or by sinking-fund requirements after all income-

mortgage bonds should cease to be outstanding. The stock would be redeemable at any time and convertible, share for share, into common stock, class A, as at the time constituted. In addition to the 773,077 shares of preferred stock to be issued in the reorganization, 1,226,923 shares would be issuable, from time to time, with the consent of the holders of the outstanding preferred stock.

The common stock, class A, would be entitled to dividends equal to $5 a share in respect of each calendar year before any dividends were paid on class B stock in respect of such year. After dividends of $5 a share on the class A common stock in respect of any year had been paid or declared and set apart for payment, dividends up to but not exceeding $5 a share might be declared and paid on the class B common stock. After the dividend of $5 on the class B common stock had been paid or declared and set apart for payment, additional dividends, if any, would be paid equally, share for share, without distinction between classes. Under certain circumstances, holders of class A stock would be entitled to elect a majority of the directors. With these exceptions, holders of both classes of common stock would rank equally for all purposes and would be entitled to 1 vote a share on all other matters. The total authorized issue of common stock, class A, would be 2,700,000 shares, of which 1,530,312 would be reserved, so long as required, to provide for the conversion of income-mortgage bonds, series A, and preferred stock, series A. The total authorized issue of common stock, class B, would be 650,000 shares.

2. *Capital funds.*—Under the debtor's plan, the new first mortgage would provide for the creation of a capital fund to which would be credited, to the extent to which net earnings after fixed charges should be available therefor, $500,000 each year until the fund should amount to $5,000,000, and thereafter at any time when payments out of this fund should reduce it below that figure. The fund would be available in the discretion of the board of directors for improvements, betterments, and equipment. The committees' plan would provide for the creation, if the board of directors should so determine, of a capital fund to be used, subject to certain limitations, for various capital expenditures or to reimburse the reorganized company's treasury for such expenditures, the amount to be set aside in capital fund out of such income of any calendar year not to exceed 2 percent of the consolidated total railway operating revenues of the reorganized company, less depreciation on roadway and structures charges against income in such year, plus the deficit in capital-fund payments for the preceding year.

3. *Allocation of new securities.*—(*a*) *Debtor's plan.*—Under the debtor's plan the holders of Fort Scott bonds would receive for each $1,000 bond and accrued interest $650 in new first-mortgage bonds, $350 in new income bonds, and 0.84 share of new common stock. The holders of prior-lien series-A bonds would receive $300 in new first-mortgage bonds, $200 in new income bonds, $250 in new prior-preferred stock, and 1.98 shares of new common stock, for each $1,000 bond and accrued interest. The holders of prior-lien series-B bonds would receive $300 in new first-mortgage bonds, $200 in new income bonds, $250 in new prior-preferred stock, and 2.2 shares of new common stock, for each $1,000 bond and accrued interest. The holders of consolidated series-A bonds would receive $250 in

new first-mortgage bonds, $200 in new income bonds, $150 in new prior-preferred stock, and 2.72 shares of new common stock, for each $1,000 bond and accrued interest. The holders of consolidated series-B bonds would receive $250 in new first-mortgage bonds, $200 in new income bonds, $150 in new prior-preferred stock, and 3.1 shares of new common stock, for each $1,000 bond and accrued interest. The Finance Corporation would receive $2,076,000 in new first-mortgage bonds, $2,076,000 in new income bonds, $1,038,000 in new prior-preferred stock, and 6,588 shares of new common stock, for principal and interest on its loans. The Credit Corporation would receive $985,800 in new first-mortgage bonds, $985,800 in new income bonds, $1,314,500 in new prior-preferred stock, and 1,566 shares of new common stock, for principal and interest on its loans. The creditor banks would receive $2,054,800 in new first-mortgage bonds, $2,054,800 in new income bonds, $1,027,300 in new prior-preferred stock, and 6,582 shares of new common stock, for their loans and accrued interest. The holders of preferred stock would receive 60 percent in new preferred stock and 40 percent in new common stock in exchange for the outstanding preferred stock. The holders of common stock would receive share for share in new common stock.

(*b*) *Committees' plan.*—Under the committees' plan the holders of the Birmingham general-mortgage and income bonds, other than bonds pledged, would receive $1,000, principal amount, in new first-mortgage bonds, series A, for each $1,000 bonds and accrued interest. Holders of Fort Scott refunding bonds would receive $700 in new first-mortgage bonds, series B, $470 of new income bonds, and $100 of new preferred stock, for each $1,000 bond and accrued interest. Holders of prior-lien bonds, series A, would receive $205 of new first-mortgage bonds, series B, $150 of new income bonds, $365 of new preferred stock, and 5.8 shares of new common stock, class A, for each $1,000 bond and accrued interest. Holders of prior-lien bonds, series B, would receive $215 of new first-mortgage bonds, series B, $160 of new income bonds, $385 of new preferred stock, and 6.15 shares of new common stock, class A, for each $1,000 bond and accrued interest.

Holders of consolidated bonds, series A, would receive $215 of new first-mortgage bonds, series B, $150 of new income bonds, $230 of new preferred stock, 3 shares of new common stock, class A, and 4.3 shares of new common stock, class B, for each $1,000 bond and accrued interest. Holders of consolidated bonds, series B, would receive $235 of new first-mortgage bonds, series B, $165 of new income bonds, $250 of new preferred stock, 3.3 shares of new common stock, class A, and 4.7 shares of new common stock, class B, for each $1,000 bond and accrued interest.

The Reconstruction Finance Corporation would receive for the loans and accrued interest on such loans the new securities issuable in respect of the collateral pledged for such loans, namely, $1,724,180, principal amount, of new first-mortgage bonds, series B, $1,210,675, principal amount, of new income bonds, $1,872,630, par value, of new preferred stock, about 24,907 shares of new common stock, class A, and about 33,469 shares of new common stock, class B. The various banks would similarly receive $1,937,810 of new first-mortgage bonds,

series B, $1,360,590 of new income bonds, $2,061,500, par value, of new preferred stock, about 27,212 shares of common stock, class A, and about 38,756 shares of new common stock, class B.

Of new common stock, class B, 30,000 shares would be reserved to distribute among the unsecured creditors and the Railroad Credit Corporation. That corporation would receive about 29,250 shares of new common stock, class B (taken at $125 a share), for its total claim, less the debtor's receivable share under the marshaling and distributing fund; and other unsecured creditors would receive the same class of stock at the same rate per share in the amount allowed by the order or orders of the court.

4. *Provisions for execution of plan.*—(*a*) *Debtor's plan.*—It is proposed in the debtor's plan that the present St. Louis-San Francisco Railway Company be continued, with necessary changes of capital structure effected by decree under section 77, as amended, or that a new corporation be organized for the purpose of carrying the plan into effect.

Certain general unliquidated claims which accrued prior to the filing of the bill in equity for the appointment of a receiver for the debtor's property are outstanding, and it is proposed in the plan that the reorganized company agree to give in payment of such of these claims as may be finally allowed 1 share of preferred stock for each $100 of debt so allowed.

The reorganized company would assume the debtor's obligations as guarantor on the outstanding bonds of terminal companies and would assume all executory contracts not rejected by the trustees of the debtor prior to the consummation of the plan. Any claimant for damages arising out of rejection of an executory contract by the trustees, as proposed, would have the status of a general creditor.

All costs of administration, allowances made by the court for expenses incurred in connection with the proceedings and the preparation and consummation of the plan, and other allowances made by the court, would be paid in cash by the reorganized company, except where the person entitled to such allowances should consent to different treatment.

(*b*) *Committees' plan.*—Under the committees' plan, claims not affected by the plan comprise current liabilities of the debtor incurred in the ordinary conduct of its business prior to the institution of the reorganization proceeding, which are entitled to priority over one or more of the mortgages of the debtor, and current liabilities and obligations of the bankruptcy trustees. To the extent that such claims, liabilities, and obligations are not paid pursuant to order of the court, they would be paid in cash or assumed by the reorganized company. The reorganized company would assume such contracts of the debtor which are executory in whole or in part, including any executory leases and liabilities under guaranties, as have been affirmed by the bankruptcy trustees and approved by the court, and also any executory contracts made by the bankruptcy trustees with approval of the court which, by their terms, do not terminate at the conclusion of the reorganization proceeding.

Other provisions of the plans proposed will be considered later in connection with the consideration of provisions of like purpose to be incorporated in the approved plan.

5. *Objections to the plans of the parties.*—The intervening Birmingham bondholders object to the treatment accorded their interests under the committees' plan because (1) they believe that such treatment would seriously jeopardize the payment of future interest to holders of those bonds; (2) it would reduce the rate of interest on the Birmingham income bonds from 5 to 4 percent; and (3) it would dilute the security which safeguards the principal of the Birmingham bonds. These Birmingham bondholders contend that they should be paid in full in cash or the maturity date of these bonds should be extended under the existing lien and interest rates, with provision for an adequate sinking fund.

The Old Colony Trust Company, trustee under the general mortgage of the Kansas City, Memphis & Birmingham Railroad Company, intervened and objects to the debtor's plan because it would extend the maturity date of the Birmingham bonds to March 1, 1954, at the same rates of interest, without specifically providing that the reorganized company should assume these obligations, because it believes the period of extension would be unjustifiable in view of the present strong priority position of these bonds, and because no provision is made for a sinking fund in connection therewith. This trustee also objects to the committees' plan upon substantially the same grounds as those referred to above in connection with the intervening Birmingham bondholders' position, and because the plan does not provide that upon the failure of the issuer to pay the new first-mortgage series-A bonds (to be issued in exchange for the outstanding Birmingham bonds) at maturity, then the new first-mortgage series-B bonds would become immediately due and payable. It is urged that under any plan of reorganization the principal of, and any accrued interest on, the Birmingham bonds should be paid in full in cash.

The Finance Corporation objects to both the debtor's plan and the committees' plan, and contends that, because of the plan and agreement of 1932 for readjustment of the debtor's finances, and the agreements of the debtor, and the assets and commitments of the bondholders, committees, and readjustment managers alleged to have been made in that plan and agreement and in connection therewith, its loan amounting to $5,190,000 and unpaid interest as of January 1, 1940, of $2,169,533 is entitled to priority over existing mortgages to the same extent that priority would be accorded to any new obligations of the receivers.

The Credit Corporation objects to both proposed plans and contends that by reason of the afore-mentioned plan and agreement of 1932, agreements of the debtor, and the assets and commitments of the others mentioned, its loan of $3,307,432, principal amount, and unpaid interest as of January 1, 1940, of $383,628 is entitled to a lien upon the property of the debtor, subject only to the liens of the Birmingham and the Fort Scott bonds, exclusive of pledged Fort Scott bonds, and prior to the liens of the prior-lien and the consolidated bonds, including the pledged Fort Scott bonds, at least to the extent that the holders of the prior-lien and consolidated bonds assented to or became bound thereby; a lien upon the distributive shares of the debtor under the marshaling and distributing plan, 1931; and a second lien upon the collateral pledged with the Finance Corporation.

The Central Hanover Bank & Trust Company and Daniel K. Catlin, as trustees under the prior-lien mortgage, and the Chase National Bank

of the City of New York and John A. Aid, as trustees under the consolidated mortgage, interveners, support the committees' plan of reorganization.

The United States Fidelity & Guaranty Company intervened as surety on appeal bonds of the debtor. It states that the debtor's plan makes no provisions for judgment claims arising therefrom and requests that the plan of reorganization approved by the Commission provide that any such claims remaining unpaid upon final decree be paid in cash or assumed by the reorganized company.

6. *Conclusions as to certain features of plan.*—Under the provisions of section 77 (d) of the Bankruptcy Act, as amended, the Commission is required to render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b)[6] and (e)[7] of the section, and will be compatible with the public

[6] Subsection (b) of section 77 provides in part that a plan of reorganization "(1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan * * *."

[7] Subsection (e) of section 77 provides that the judge shall approve the plan certified to the court by the Commission if satisfied, after hearing, and without hearing if no objections are filed, "that: (1) It complies with the provisions of subsection (b), is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge," except that allowances for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the proceedings and plan by parties in interest and by reorganization managers and committees, or other representatives of creditors and stockholders, and the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositaries, and such assistants as the Commission with the approval of the judge may especially employ, may be paid in securities provided for in the plan, if those entitled thereto will accept such payment. Subsection (e) further provides that upon receipt of certification by the Commission of the results of submission to creditors and stockholders, "the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided*, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is

interest; or to render a report and order in which it shall refuse to approve any plan. Each of the plans proposed appears to meet the requirements of subsection (b) (1) and (5) in that they would include provisions for modifying and altering the rights of creditors and would provide adequate means for the execution of the plan. Each plan also appears to meet the requirements of subsection (e) (3), and the proponents of each plan would no doubt in proper time be able to meet the requirements of subsection (e) (2). There remains to be determined whether any of these plans meets or some other plan may meet, the requirements of subsection (b) (4) and subsection (e) (1) and is compatible with the public interest.

## II. NEW CAPITALIZATION AND CHARGES

To meet the requirement of compatibility with the public interest, the plan proposed should in our view provide a capitalization represented by securities with some prospects for yielding a return to their holders, and having something more than mere speculative value. To meet these requirements, as well as the requirements of subsection (b) (4) of section 77, there must be adequate coverage of fixed charges by the probable earnings available for the payment thereof.

### A. ASSETS, CAPITALIZATION, TRAFFIC, REVENUES, ETC.

1. *Book assets and valuation figures.*—The consolidated general balance sheet of system companies as of December 31, 1937, shows the following assets: Road and equipment $426,452,105, deposits in lieu of mortgaged property sold $828,168, miscellaneous physical property $677,903, investments in affiliated companies $1,409,906, and other investments $11,531,386, a total of $440,899,468 of investments. Current assets were $15,101,920, including $6,277,579 in cash and $5,813,381 in material and supplies. Deferred assets were $229,438, and unadjusted debits were $1,304,563. Total assets were $457,535,389. A total of $103,574,150 of securities issued or assumed by system companies was pledged, and a total of $21,653 was reported as held unpledged.

Liabilities shown on the same balance sheet comprise common stock $65,543,226, preferred stock $49,158,300, grants in aid of construction $525,666, long-term debt $234,547,597, current liabilities $125,471,849, deferred liabilities $199,470, unadjusted credits $48,904,639, and a corporate deficit of $66,815,358 after taking into account additions to property through income and surplus of $1,884,039 and appropriated surplus not specifically invested of $233,455.

Current liabilities include notes payable, secured, $13,634,295, traffic and car-service balances payable $350,753, audited accounts and wages payable $2,652,826, miscellaneous accounts payable $111,782, interest matured unpaid $63,793,532, dividends matured unpaid $13,565, funded debt actually outstanding matured unpaid $42,375,720, unmatured interest accrued $2,150,745, and other current liabilities $388,631.

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satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts''; and that the plan conforms to the above-stated requirements of this subsection.

Unadjusted credits include tax liability $1,974,424, insurance and casualty reserves $12,694, accrued depreciation of road $1,237,108, accrued depreciation of equipment $44,429,977, and other unadjusted credits $1,250,437.

As of December 31, 1936, the original cost of the property of the debtor was $208,133,792 for road and $89,354,756 for equipment, the cost of reproduction new $239,492,025 for road and $94,474,274 for equipment, the cost of reproduction less depreciation $168,318,419 for road and $48,351,025 for equipment, and the value of lands and rights $22,030,860. The cost of reproduction less depreciation, plus the value of lands and rights, and an allowance of $3,955,800 for working capital, amounts to $242,656,104. It is further shown that the cost of reproduction less depreciation of road and equipment of all other system companies plus the value of lands and rights and an allowance of $58,100 for working capital, amounts to $13,363,287. The latter sum when added to the comparable figure for the debtor would produce a total for the system of $256,019,391. Cost-of-reproduction-new figures were based on revised inventories as of December 31, 1934, with consideration given to subsequent changes in property items as disclosed by the carrier's records for 1935 and 1936. Period prices were applied, determined from consideration of records of prices and their individual trends prevailing in 1936 and during a period of time prior and subsequent thereto. Cost of reproduction less depreciation was determined in accordance with methods frequently explained in the valuation reports of this Commission.

2. *Traffic and revenues.*—The revenue freight and the freight revenues of the system lines increased each year, rising from 24,102,790 tons and $62,498,060, respectively, in 1923, to 26,317,707 tons and $71,681,444, respectively, in 1926, then declined each year, except 1929, amounting to 13,457,692 tons and $35,717,366, respectively, in 1932, and 13,756,787 tons and $34,932,836 in 1933. In 1929 the number of tons was 27,097,973 and the freight revenues $70,376,366. In 1934, 1935, 1936, and 1937, 14,054,112, 13,981,609, 16,888,918, and 17,625,909 tons, respectively, were moved, producing revenues of $35,555,780, $35,834,793, $42,298,701, and $42,909,254, respectively. Freight revenues derived from principal commodities for the years indicated were as follows:

| Derived from— | 1926 | 1936 | 1937 |
|---|---|---|---|
| Products of agriculture | $12,190,741 | $7,245,767 | $7,749,411 |
| Animals and products | 3,750,524 | 2,081,096 | 2,016,735 |
| Products of mines | 9,318,796 | 5,223,890 | 5,428,021 |
| Products of forests | 6,889,056 | 2,927,070 | 3,003,648 |
| Manufactures and miscellaneous | 30,070,927 | 21,398,913 | 21,405,136 |
| Less than carloads | 9,461,400 | 3,421,965 | 3,308,303 |

The average revenues per ton for the years 1931-37 were $2.61, $2.65, $2.54, $2.53, $2.56, $2.51, and $2.44, respectively.

The system lines carried 9,457,960 revenue passengers in 1923, producing revenue of $20,597,709. Each year thereafter the number of passengers decreased until 1933, when 690,022 passengers were carried, producing revenue of only $2,340,957. An improvement in this traffic began in 1934 when 980,119 passengers produced total passenger rev-

enues of $2,497,880. The improvement continued through 1936 when 1,370,491 passengers were carried and passenger revenues of $3,451,938 were received. There were 1,418,115 passengers carried in 1937, producing revenues of $3,785,055. The average revenues per passenger for the years 1931-37, inclusive, were $3.371, $3.404, $3.393, $2.549, $2.519, $2.519, and $2.669, respectively.

3. *Earnings and expenses.—Earnings available for fixed charges.*— The system railway operating revenues increased from $89,633,152 in 1923 to $94,715,375 in 1925, declined to $85,782,818 in 1928, increased to $89,109,286 in 1929, declined each year thereafter, reaching $40,693,596 in 1933, and then increased each year, reaching $51,218,937 in 1937. The railway operating expenses in 1923 were $65,934,620 and remained at approximately that figure until 1927, when they were reduced to $62,263,277. They were $59,783,801 in 1928, $62,847,958 in 1929, and $33,822,276 in 1933, and then increased each year, reaching $41,170,783 in 1936. In 1937 these expenses were $43,194,345. The operating ratios for the years 1923, 1927, 1928, 1929, 1933, 1936, and 1937 were 73.56, 69.76, 69.69, 70.53, 83.11, 82.04, and 84.33 percent, respectively. Other operating charges, embracing railway tax accruals, uncollectible railway revenues, hire of equipment, and joint-facility rents, ranged from $6,464,324 in 1925 to $3,231,562 in 1937. Nonoperating income increased from $451,827 in 1923 to $3,778,629 in 1928, declined to $334,684 in 1932, and again declined from $558,339 in 1933 to $153,071 in 1936, but increased to $182,105 in 1937. Other deductions from income, embracing rentals, miscellaneous tax accruals, separately operated properties, miscellaneous income charges, and sinking and other reserve funds, ranged from $766,241 in 1923 to $64,072 in 1937.

Income available for payment of interest increased from $18,339,468 in 1923 to $24,636,429 in 1928, declining to $1,476,347 in 1935, increasing to $5,197,171 in 1936, and declining to $4,911,063 in 1937. Interest on fixed-charge obligations ranged from $10,039,232 in 1923 to $13,620,863 in 1928, and from $12,500,382 in 1929 to $13,518,941 in 1932, decreasing each year thereafter to $12,841,172 in 1937.[8] Net income ranged from $3,762,859 in 1923 to $10,192,073 in 1929, and decreased to $5,621,536 in 1930. From 1931 to 1937, the deficits in net income were $3,255,763, $10,093,677, $10,261,499, $10,638,308, $11,560,016, $7,722,727, and $7,930,109, respectively.[9] The fixed interest charges were earned from 1.83 times in 1923 to 2.11 times in 1925, 1.44 times in 1930, 0.76 time in 1931, 0.11 time in 1935, and 0.40 time in 1936.

The average income available for interest during the 10-year period 1923-32 was $18,686,538 a year, and for the 4-year period 1933-36, $3,107,818 a year. The latter figure would be increased to $3,287,318 by including the canceled taxes of $718,000 as income available for interest in 1936. As above indicated, the income available for interest

[8] In addition to the fixed-interest obligations for the years 1923-28, the interest paid on cumulative adjustment-mortgage bonds averaged $2,228,799 a year, and on income-mortgage bonds it averaged $2,022,290 a year.

[9] The 1936 and 1937 deficits include approximately $718,000 and $82,000, respectively, of taxes under the Railroad Retirement Act of 1935 and Federal and State unemployment acts which were repealed in July 1937 and credited back in December 1937.

in 1935 was less than that in any other year during the 14-year period and decreases the average. The average for the period 1932-36, omitting 1935, was $3,595,047 a year, not including the canceled taxes, and $3,774,547 inclusive of those taxes. These last two averages capitalized at 5 percent produce $71,900,940 and $75,490,940, respectively.

If income available for payment of interest, as shown by the books of account of the debtor and system companies named, were adjusted so as to correct accounting not in conformity with the Commission's accounting regulations, further adjusted to include income items entered in profit and loss account by permission of the Commission, and to give retroactive effect to current regulations governing accounting for depreciation of equipment and to tax legislation subsequently enacted, the averages for the 5 years 1930 to 1934 would be those set forth in the following table:

| Item | Debtor | Birmingham Belt R. R. | Fort Worth & Rio Grande Ry. | Gulf, Texas & Western Ry | Quanah, Acme & Pacific Ry. | St. Louis, S. F. & Texas Ry. |
|---|---|---|---|---|---|---|
| 1. Interest on funded and unfunded debt | $13,253,192 | $27,382 | $708 | $100,023 | $162,921 | [1] $44,449 |
| 2. Interest as in item 1 after correcting accounting | 13,252,518 | ..... | 527 | ..... | ..... | ..... |
| 3. Income available for payment of interest [2] | [3] 8,533,405 | 42,960 | [1] 359,727 | 73,149 | 62,848 | [1] 310,875 |
| 4. Income as in item 3 after correcting accounting | 7,820,659 | 42,960 | [1] 345,389 | ..... | 49,309 | [1] 422,229 |
| 5. Income as in item 3 after adjustment to include items entered in profit and loss account | 6,212,686 | 42,960 | ..... | ..... | ..... | ..... |
| 6. Income as in item 3 after adjustment to give retroactive effect to current regulations governing accounting for depreciation of equipment | 7,768,949 | ..... | ..... | ..... | 48,117 | ..... |
| 7. Income as in item 3 after adjustment to give retroactive effect to new legislation | 6,625,037 | 37,099 | [1] 371,709 | ..... | 35,312 | [1] 465,957 |

[1] Deficit.
[2] As stated on carriers' books of account
[3] Includes an average of $445,788 of interest and dividends receivable from the affiliated companies named in this table, except the Fort Worth & Rio Grande Ry

The income of the Gulf, Texas & Western Railway Company on and since July 1, 1930, has been from rent equal to the interest accruing on its outstanding bonds, and amounting to $100,000. All current taxes and maintenance and operating costs of this line are assumed by the lessee. The only income items recorded on the books of the Jonesboro, Lake City & Eastern Railroad Company, Butler County Railroad Company, St. Louis, Kennett & Southeastern Railroad Company, and the Miami Mineral Belt Railroad Company during the 5-year period are relatively small amounts generally not in excess of $12,000, reflecting transactions of the periods prior to the dates these lines were leased to the debtor.

The debtor's net railway operating income of $5,880,915 for 1936, as shown by the books of account, was approximately 2.4 percent of the figure given above for cost of reproduction less depreciation plus value of land and rights and the allowance for working capital. The system's net railway operating income of $5,116,889 in 1936, as shown by the books of account, was approximately 2 percent of the figure given above for corresponding elements of value for the system as a whole.

Consolidated income available for payment of interest from 1928 to 1938, as shown by the books of account, and as adjusted to eliminate the Fort Worth & Rio Grande Railway Company (not now owned by the debtor), and taxes charged and later credited back, and further adjusted as regards the years 1930 to 1934, inclusive, to correct accounting not in conformity with our accounting regulations, to include income items entered in profit and loss account by permission of the Commission, and to give retroactive effect to current regulations governing accounting for depreciation of equipment was as follows:

| | As shown by books | Books adjusted | | As shown by books | Books adjusted |
|---|---|---|---|---|---|
| Year 1928 | $24,636,429 | $24,648,827 | Year 1934 | $2,552,363 | $2,698,485 |
| Year 1929 | 22,692,455 | 22,869,738 | Year 1935 | 1,476,348 | 1,370,988 |
| Year 1930 | 18,405,651 | 17,608,663 | Year 1936 | 5,197,171 | 6,207,498 |
| Year 1931 | 10,074,729 | 10,288,049 | Year 1937 | 4,911,062 | 4,208,109 |
| Year 1932 | 3,425,264 | 3,553,047 | Year 1938 | 1,241,888 | |
| Year 1933 | 3,205,389 | 3,071,075 | | | |

B. CONCLUSIONS AS TO NEW CAPITALIZATION AND FIXED CHARGES

The average income available for payment of interest during the last 7 years stated was $3,201,671 annually. All of this sum was not, however, and could not have been, paid out in interest, if the property was to be properly managed, since, among other reasons, capital requirements which had to be financed from earnings rather than borrowing were large. From the appointment of the receivers in November 1932, there was expended for additions and betterments to the property to December 31, 1937, about $9,397,000 of cash or its equivalent, or about $1,819,000 a year. To March 1, 1938, interest payments were only about $5,226,000, or about $1,000,000 a year, although an average for the 6 years ended with 1938 of about $3,150,000 annually was apparently available. This requirement, that a part of income be available for capital purposes, and not all pledged for debt service, is not peculiar to receivership or bankruptcy; sound financing demands it at all times. The burden is, however, generally heavier during receivership and bankruptcy than during periods when the company is not in default, especially if, as in the case of the debtor, receivership was brought about largely through excessive fixed charges, and the proportion of revenues spent on maintenance was increased during the period of default.

The annual interest on the undisturbed equipment-trust obligations as of June 30, 1937, and the annual fixed interest on the outstanding Birmingham bonds total $704,000. The annual fixed interest on the new first-mortgage bonds proposed in the debtor's plan totals $3,252,000, and the contingent interest on the new income bonds each year totals $2,452,400. Thus the annual fixed interest charges under the debtor's plan total $3,956,000. The dividends on the new prior-preferred stock, if paid in full at the rate proposed in the plan, would total $2,524,400, and on the new preferred stock $1,474,700. Sinking fund and provision for capital fund would require about $806,548 annually. The total of these items is $11,214,048.

The annual fixed charges under the committees' plan would be $207,664 on equipment obligations, $260,247 on first-mortgage bonds, series A, and $2,868,585 on first-mortgage bonds, series B, a total of $3,336,496. Contingent interest on the income bonds amounts to $2,271,706. Capital-fund charges would be $1,000,000, when total operating revenues were $50,000,000, and would exceed $1,000,000 with any further increase in total operating revenues. Income-mortgage sinking fund initial requirement would be $252,412 (0.5 percent of greatest principal amount of income bonds outstanding). Preferred-stock dividends would be $3,865,386. The total requirements for interest, preferred dividends, capital fund, and sinking fund would thus be $10,726,000.

Both plans of reorganization proposed by the parties give direct and definite consideration to the question of financing capital requirements from earnings in determining the charges which may or must precede the payment of contingent interest; but the same consideration does not appear to have been given the same question in determining the amount of appropriate fixed charges, although a part of such expenditures, at least, can no more be avoided than can operating expenses. With income available for interest averaging only $3,201,671 during the last 7 years, the fixed interest charges proposed for the reorganized company by the three bondholders' committees and by the debtor both appear excessive, even though, as is the fact, maintenance expenditures have been in excess of normal. Reducing by 10 percent the fixed-interest debt proposed by the bondholders' committees would reduce the fixed-interest requirements to $3,000,117 on a 4-percent basis for the new bonds. This appears a reasonable amount for the reorganized debtor to assume, and is approved.

The plan of reorganization proposed by the committees is based on a total of present capital liability and other liabilities proposed to be funded in the plan of $491,309,628 as of January 1, 1940[10] This reflects $1,457,000 decrease in the equipment obligations in, and an increase of $17,748,603 in the interest over, the debtor's figures as of August 31, 1938. As noted above, the new capitalization proposed by the debtor, including no-par-value securities at the stated values, would total $387,055,170 as of August 31, 1938, and that proposed by the 3 bondholders' committees would comprise $211,884,861 of funded debt and preferred stock having a par value, 1,100,181 shares of class A common stock without par value, and 614,938 shares of class B common stock without par value, the class A common stock being preferred as to dividends over the class B common stock to the extent of $5 a share a year. Since the class A common stock would be exchanged at the rate of $100 a share for claims having priority over those for which the class B common stock would be issued, and in view of the amount of the dividend preference, an asset and prospective earnings value of $100 a share for the class A common stock appears to be called for. Thus a capitalization substantially in excess of $321,902,961 must be justified if any of the class B stock is to be issued. If the latter be taken at $50 a share, the capitalization proposed by the committees is in effect over $350,000,000, a sum equaling the capitalization at 5 per-

[10] Does not take into account payments of interest amounting to $2,785,118 made after the filing of the plan.

cent of annual earnings of $17,500,000. In the 8-year period 1931 to 1938 the debtor's consolidated net railway operating income has never approached that figure, and has averaged only $3,739,507 annually. The latter sum, capitalized at 5 percent, amounts to only $74,790,140. Exclusive of the Fort Worth & Rio Grande Railway Company, subsequently sold, the value as of December 31, 1936, on a reproduction-less-depreciation basis of roadway structures and equipment plus present value of lands, working capital, and investments in nonsystem companies, was approximately $260,000,000.

## III. PLAN APPROVED

### A. CAPITALIZATION; FIXED CHARGES

Considering the entire record and taking into account the reproduction value of the property remaining in service after the abandonments and the favorable past earnings, as well as the unfavorable recent earnings, it would appear that the total capitalization after reorganization should be about $240,000,000. Of the total capitalization proposed, rather less than half should be in the form of debt and rather more than half in the form of stock, of which the amount of no-par common stock, taken at $50 a share, should somewhat exceed the preferred stock. This result may be attained by reducing the fixed-interest debt proposed by the three committees by 10 percent, the contingent-interest debt by 20 percent, and the preferred stock by 20 percent, producing approximately the following capitalization:

| | |
|---|---|
| Fixed-interest debt, 4 percent | $ 75,685,314 |
| Contingent-interest debt, 4½ percent | 40,385,884 |
| Preferred stock, 5 percent | 61,846,170 |
| Common stock, no-par value stated at $50 a share | 62,082,632 |
| Total | 240,000,000 |

Fixed interest charges for 1940 under such capitalization would amount to $3,000,117 and, as shown below, there should be provided for additions and betterments each year out of income approximately $1,125,000, and for unconditional sinking funds on fixed-interest bonds to be outstanding $32,531. Contingent interest charges would be $1,817,365, and for contingent-interest debt there should be provided, as shown below, sinking-fund payments of $201,929 a year, or a maximum requirement of approximately $6,176,992 before appropriation for dividends on the preferred stock. The preferred dividends would amount to $3,092,309, making the maximum requirements for interest, special funds, and preferred dividends, approximately $9,269,251 before any income would be available for payment of dividends on common stock. Should income available for interest, other requirements, and dividends equal that of 1931, viz, $10,288,049, which is reasonably possible, there would be approximately $1,018,748 for payment of dividends on the common stock, or enough to pay dividends thereon at the rate of about $0.82 a share.

The capitalization proposed would give the reorganized company a well-balanced financial structure, should afford adequate means

for such future financing as may be necessary, should enable the carrier to maintain its properties adequately, and should not lead to further need of judicial reorganization. It includes only such securities as would give the holders thereof some prospect of interest or dividends, and would otherwise be compatible with the public interest. Fixed charges, including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased road would be of such amount that, after due consideration of the probable prospective earnings of the property in the light of its earnings experience and all other relevant facts, there would be adequate coverage of such fixed charges by the probable prospective earnings available for the payment thereof.

(Superseded matter is here omitted)

C. PARTICIPATION IN REORGANIZATION

The road is in good physical condition. No new securities are needed to finance any rehabilitation work. All securities issued in accordance with the reduced capitalization proposed herein will be available for distribution to present security holders.

1. *Rights of creditors.*—(*a*) *Liens.*—Equipment-trust certificates, other than those not presented for payment at maturity, outstanding on August 31, 1938, were of three series. Series BB, issued February 15, 1926, amounting to $1,558,000 as of August 31, 1938, covers equipment which originally cost $10,462,128. Series CC, issued May 15, 1928, amounting to $2,000,000 as of August 31, 1938, covers equipment which originally cost $8,236,272. Series DD, issued April 1, 1930, amounting to $3,773,000 as of August 31, 1938, covers equipment which originally cost $10,849,959. The book value and the depreciated book value of this equipment on August 31, 1938, were $30,043,250 and $18,536,320, respectively. The car-hire net receipts for 1937 were 4.23 percent of the equipment obligations outstanding on August 31, 1938.

The Birmingham general-mortgage bonds and income bonds as of December 1936, were secured by first and second liens, respectively, on 290.72 miles of the debtor's road extending between Birmingham, Ala., and Memphis, Tenn., and on certain equipment. Exclusive of lands and rights, the original cost of this property was $14,225,806 and the cost of reproduction less depreciation as of December 31, 1936, was $15,225,806. The value of lands and rights was $1,408,754.

The Fort Scott refunding-mortgage bonds, subject to claims for prior equities against the pledged bonds, were secured by a direct first lien on 823.66 miles of the debtor's road in Kansas, Missouri, Arkansas, Oklahoma, and Tennessee, and 347 units of equipment, and a junior lien on the property securing the Birmingham general-mortgage bonds and income bonds. In addition $399,500 of the income bonds were pledged under the Fort Scott mortgage. Exclusive of lands and rights, the original cost of direct first-lien property was $60,331,393 and the cost of reproduction less depreciation as of December 31, 1936, was $32,662,151. The value of lands and rights was $5,828,495.

The collateral-trust mortgage of 1887 has been released, and there were $4,000 of such bonds outstanding secured by deposit of $6,000 of United States Government bonds.

Subject to claims for prior equities hereinafter discussed, the prior-lien bonds, series A, B, and E, were secured by a direct first lien on 3,660.76 miles of the debtor's road and 9,767 units of equipment, a second lien on the equipment subject to equipment trusts, and a junior lien on the property subject to the Fort Scott refunding-mortgage and the Birmingham general-mortgage bonds and income bonds, the last mentioned being subject to an intermediate lien of the consolidated mortgage for $3,548,732. Exclusive of lands and rights, the original cost of direct-first-lien property was $169,677,183 and the cost of reproduction less depreciation as of December 31, 1936, was $136,317,241. The value of lands and rights was $14,793,611. Except as otherwise noted, the prior-lien bonds were additionally secured by pledges of all the bonds and stocks of the wholly owned system companies mentioned above.

The consolidated-mortgage bonds, series A and B, were secured by a direct lien on all property of the debtor, subject to liens of equipment obligations and prior existing mortgages discussed above, additionally secured by pledges of securities totaling $87,428,650 in principal amount and comprising $1,293,250 of prior-lien series-A 4-percent bonds, $46,606,300 of prior-lien series-B 5-percent bonds, $17,851,100 of prior-lien series-E 6-percent bonds, and $21,678,000 of Fort Scott refunding-mortgage 4-percent bonds, and further secured by the intermediate lien for $3,548,732 on the Fort Scott properties prior to the lien of the prior-lien mortgage.

The loans from the Mercantile-Commerce Bank & Trust Company of St. Louis, First National Bank of St. Louis, Bankers Trust Company, and the Central Hanover Bank & Trust Company were each collaterally secured by pledge of $625,000 of consolidated series-B 6-percent bonds. The loans from the Guaranty Trust Company and the Chase National Bank were secured by pledges of $1,562,500 and $4,183,500 of consolidated series-B 6-percent bonds, respectively. The loans from the Railroad Credit Corporation, amounting to $3,307,432 in principal amount, were collaterally secured by pledge of the debtor's distributive share under the marshaling and distributing fund in the book amount of $195,055 as of October 1, 1938, and by the debtor's equity in all collateral deposited with the Finance Corporation. The loans of $5,190,000 in principal amount from the latter corporation were collaterally secured by pledge of securities issued by the debtor totaling $7,500,000, comprising $218,000 of prior-lien series-A 4-percent bonds, $28,000 of prior-lien series-B 5-percent bonds, $1,561,000 of consolidated series-A 4½-percent bonds, and $5,693,000 of consolidated series-B 6-percent bonds. The two creditors last named contend that they are additionally secured by special equities.

In the determination of the proper distribution of the new securities, there are no disputed questions of lien to be decided, except those raised by the Reconstruction Finance Corporation and the Railroad Credit Corporation. These two institutions claim, in fact and effect, equitable liens superior to the mortgages on most of the system property, at least as against those holders of prior-lien and consolidated-mortgage bonds who assented to the plan of readjustment of 1932, subsequently abandoned. They further contend that the bank

loans are subordinated to their claims. These claims are hereinafter discussed.

The Old Colony Trust Company, trustee, holds $500, principal amount, of Birmingham income bonds, and the debtor holds $2,000 of equipment-trust certificates, series BB, $154 of prior-lien series-A bonds, and $19,000, principal amount, of Birmingham income bonds.

(*b*) *Segregation of earnings.*—There has been no segregation of the system income account to determine the allocation of revenues and expenses attributable to the portion of the road subject to the Birmingham mortgage, it being conceded by the debtor and the bondholders' committees that the earnings of the line are sufficient to warrant the issue of par for par of new fixed-interest securities to holders of the outstanding bonds, and that a segregation study of this line was unnecessary. Interest is being paid currently on both issues of Birmingham bonds.

Under a formula prepared by the accounting officers of the debtor with assistance from representatives of the bondholders' committees, segregation of income has been made as between lines covered by the several liens of the Fort Scott mortgage, the debtor's other system lines north of the Red River, and the debtor's system lines in Texas. Under this formula, income available for interest in 1934, 1936, and 1937, assigned to the several divisions of the system was as follows:

| Assigned to— | 1934 | 1936 | 1937 |
|---|---|---|---|
| Fort Scott lines | $1,271,725 | $2,875,686 | $2,095,898 |
| Other lines north of Red River[1] | 2,066,459 | 3,780,565 | 2,353,196 |
| All lines north of Red River | 3,338,184 | 6,656,251 | 4,449,094 |
| Texas lines[1] | *[2]812,845* | *[2]755,608* | *[2]265,447* |
| All system lines | 2,525,339 | 5,900,643 | 4,183,647 |

[1] Prior-lien lines.
[2] Deficit.

Of the amounts available for interest on all system lines, the Fort Scott lines earned 50.3 percent thereof in 1934, 48.8 percent in 1936, and 50.1 percent in 1937. Adjusting these ratios to exclude the Kansas City, Clinton & Springfield Railway, abandoned in 1935, and the Fort Worth & Rio Grande Railway, sold in 1937, the results are 44 percent for 1934, 46.4 percent for 1936, and 49.4 percent for 1937, with a 3-year weighted average of 47.55 percent.

(Obsolete matter is here omitted)

(*d*) *U. S. Fidelity & Guaranty Company.*—The question raised by the United States Fidelity & Guaranty Company appears to be solely one of classification of claims and, as such, a question for the court and not the Commission.

(*e*) *Undisturbed securities.*—All plans of reorganization presented by the parties provide, and all the evidence indicates, that the equipment obligations are very well secured and should be assumed undisturbed as to terms by the reorganized company. This is approved. In view of this provision, we find that the interests of

the holders of equipment obligations will not be materially and adversely affected by the plan.

(Obsolete matter is here omitted)

(*b*) *Fort Scott, prior-lien, and consolidated-mortgage bonds, the Reconstruction Finance Corporation, and the Railroad Credit Corporation.*—In relation to the security provided by the 4,719 miles of railroad owned by system companies on December 31, 1937, the two Birmingham issues stand first and second among mortgage liens in respect of 288 miles, the Fort Scott mortgage first in respect of 831 miles, and the prior-lien mortgage first in respect of 3,600 miles. The Fort Scott mortgage has a lien next in order on the mileage subject to the two Birmingham issues; and this mileage is included in the Fort Scott district. In the allocation of new securities it is necessary to consider the relative earnings of the Fort Scott district and the prior-lien district, income available for the payment of interest produced by traffic moved on the Fort Scott district being a larger proportion of the requirements of the bonds secured thereby than is the case with the prior-lien district. For this purpose, system earnings and expenses for the years 1934, 1936, and 1937 were, as hereinbefore indicated, analyzed and assigned to one or the other of the two districts or divided between the two in accordance with a formula based generally on proration according to mileage. The formula has not been approved by any one of the three bondholders' committees, but the results coincide with the basis adopted for allocation of securities in their plans. The formula was prepared by the accounting officers of the debtor with assistance from representatives of the three committees.

The formula conforms in a general way and in most respects to the one approved by the Commission, division 4, in *New York, N. H. & H. R. Co. Reorganization*, 224 I. C. C. 723, the principal points of variance being that freight revenues on traffic between districts are allocated on a straight mileage prorate with no terminal allowances, and that 5 percent of valuation instead of 4½ percent is used in computing the credit for equipment used on one mortgage district and subject to the lien of the other. Tests made indicated that the application of terminal allowances was unnecessary, and would not have altered the result importantly. The higher rate used for equipment credits appears to be justified by the large rentals received by the debtor for use of its equipment on foreign lines, these rentals being apportioned in the formula not on the basis of the ownership of the equipment but on the relative extent to which equipment was used on each district.

The segregation studies show that, eliminating the Kansas City, Clinton & Springfield Railway, abandoned in 1935, and the Fort Worth & Rio Grande Railway, sold in 1937, the Fort Scott lines in 1934, 1936, and 1937 earned 47.55 percent of system income available for payment of interest, and the prior-lien lines 52.45 percent. These ratios are approved as a basis for the allocation between the two districts of new fixed-interest securities under our plan of reorganization. Applying the ratios indicated, $1,426,556 of the permissible fixed interest charges of $3,000,117 should be allocated to the Fort Scott district and $1,573,561 to the prior-lien district.

Interest on the equipment obligations to be assumed by the reorganized company, being a prior lien on property subject to the prior-lien mortgage, is deductible in arriving at the share of income assignable to holders of other claims secured by lien or priority on the prior-lien district.

(Obsolete and superseded matter is here omitted)

Whether the unsecured creditors may share in the distribution of the new securities depends upon the value of assets free of lien, if any; and it appears that there are no free assets. After grants of specific railroads and other properties in earlier granting clauses, the eighth granting clause of the prior-lien mortgage conveys the following:

> Eighth: All other railroads, lines of railroad, extensions, branches and bridges, lands, equipment, rolling stock, property rights, and generally all property, real and personal, including stocks, bonds, obligations and indebtedness, rights, privileges and franchises owned at the date of the delivery of this indenture or at any time thereafter acquired by the railroad company and all tolls, revenues, earnings, income, rents, issues and profits thereof.

The only qualification of this grant was for existing liens, and, in the case of after-acquired property, for liens existing at the time of acquisition. Accordingly, we find that the interests of unsecured creditors, including such claims as are preferred over general creditors but not over any of the mortgages, have no value and that all of the new common stock should be allotted to the prior-lien bonds outstanding and pledged.

(Superseded matter is here omitted)

(*e*) *Conclusions as to certain contentions.*—As has been shown, the holders of neither the 4-percent nor the 5-percent prior-lien bonds will have their claims satisfied in full. Counsel for the Gans executors contends that accordingly the allocation of new securities as between these two outstanding issues should be on the basis of principal only and not principal plus interest, citing *American Iron Co* v. *Seaboard Air Line Ry. Co.*, 233 U. S. 261, wherein it is shown that in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt. However, the rule laid down in that case was not intended for application where creditors have, as here, agreed among themselves on a different basis of distribution. The District Court of the United States for the Western District of New York said in *In re Wickwire Spencer Steel Co.*, 12 Fed. Supp. 528, 535:

> The reason for the rule deferring payment of interest is apparent. Claims bearing interest at unequal rates would receive unequal proportions on account of the difference in rates, where the company was insolvent. Since such an inequality would result from operation of law rather than by agreement of parties, interest is suspended.

Here, there was an agreement of parties on this subject contained in the prior-lien mortgage, which provides that in case of a sale of the property under the powers of sale granted in the mortgage or pursuant to judicial proceedings, and in case the proceeds of such sale shall be insufficient to pay in full the whole amount due and unpaid upon the bonds, such proceeds shall be applied to the pay-

ment of the principal and interest of the bonds, without preference or priority of principal over interest, or of interest over principal, or of any installment of interest over any other installment of interest, ratably to the aggregate of such principal and the accrued and unpaid interest. The contentions of counsel are accordingly overruled.

Counsel for the Gans executors contends further that the pledges of collateral security under the secured notes issued to the banks, and also the pledge by the debtor under the consolidated mortgage of other obligations of its own, were in violation of the constitution of the State of the debtor's incorporation, the State of Missouri, as offending that provision thereof that no corporation shall issue stock or bonds, except for money paid, labor done, or property actually received, and all fictitious increases of stock or indebtedness shall be void.

It is not shown that any of the pledged bonds, the validity of the pledge of which is attacked, were issued prior to the enactment of section 20a of the Interstate Commerce Act; and it is not alleged that the debtor has failed to comply with any of the requirements of section 20a in respect of such pledges. As to railroad security issues authorized pursuant to such section, the applicable rule, stated in paragraph 7 of section 20a, provides that the jurisdiction conferred on this Commission by the section is exclusive and plenary, and that a carrier may issue securities and assume obligations or liabilities in accordance with the provision of the section without securing approval other than as specified therein. Where brought into question, the provisions of this paragraph and similar provisions of other paragraphs of the Interstate Commerce Act have been construed as setting aside or suspending, or as not limited by, the operation of inconsistent State laws, or else as not open to collateral attack. *Minneapolis, St. P. & S. S. M. Ry. Co.* v. *Wisconsin R. Comm.*, 197 N. W. 352, *Venner* v. *Michigan Central R. Co.*, 271 U. S. 127, *New York Central Securities Co.* v. *United States*, 287 U. S. 12, *Transit Comm.* v. *United States*, 289 U. S. 121, and *Texas* v. *United States*, 292 U. S. 522. The further contention of counsel is also overruled.

The Gans executors likewise contend that the allocation of new securities to the Fort Scott and prior-lien bondholders is inequitable because it assigns too large a proporiton of the total to Fort Scott bondholders in relation to the physical valuation of that property. We find no merit in this contention. While it might be argued that if the property were to be withdrawn from the system, the physical valuation of the Fort Scott property would be insufficient to warrant the total issue of new securities approved herein, in respect thereof, we hold that the study of segregation of earnings affords a fair basis for the distribution of the new securities, and that the total distributed is, for reasons hereinbefore stated, reasonable. The net earnings attributable to the Fort Scott district, in proportion to reproduction value are over twice those of the prior-lien district.

The consolidated committee argues that there is clear authority for the rule that junior creditors or stockholders are not debarred from receiving securities of the same class as those allotted to senior creditors, even when the value of the assets is less than the amount of the senior claim. In the absence of special circumstances, we hold the

rule to be otherwise, where, as here, the senior creditors affected refuse their consent and the junior creditors are not called upon to subscribe any cash. *In re A. C. Hotel Co.*, 93 Fed. (2d) 841, cited by the committee, a case providing for participation by junior creditors and stockholders where the assets had a value less than the first-mortgage indebtedness, was one in which 95 percent of the holders of the first-mortgage bonds, 90 percent of the holders of the second-mortgage bonds, 81 percent of the unsecured creditors, and 100 percent of the stockholders, who had filed their claims, had in writing approved the plan. The contention of the consolidated committee and a similar contention of the trustee under the consolidated mortgage are overruled.

Albert L. Reed, intervener, asserts that the properties supporting the consolidated bonds have guaranteed both the principal and interest of the pledged Fort Scott bonds, and contends that the consolidated bondholders are therefore in the position of being their own guarantors, and that they cannot legally insist on receiving anything as a result of the pledged Fort Scott bonds until they have made good their guaranty. Apparently, the only guarantor of the pledged Fort Scott bonds is the debtor. While it is true that the debtor owns the guaranteed pledged bonds, the intervener does not allege, nor does the record show, that the outstanding Fort Scott bonds are guaranteed by the debtor or anyone else.[11] The pledges were all made more than 4 months prior to the filing of the petition in bankruptcy. It thus does not appear that the holders of the outstanding Fort Scott bonds can avail themselves of any guaranty, nor do we find any other reason to conclude that any of the Fort Scott bonds are subordinated to any of the others. The contentions of the intervener are overruled.

The debtor argues that no plan of reorganization which does not represent a composition between the debtor and its creditors, or which excludes the shareholders, is within the intent of the act. In view of the express provisions of the second paragraph of subsection 77 (e), the contention is not sustained. The debtor moved seasonably to strike from the record the report of our Bureau of Valuation, or parts thereof, on which we have based our findings as to the elements of physical value of property, on the ground that its filing was not authorized by the act and that it does not state facts as to cost of reproduction value or accrued depreciation. The filing of the report in question was authorized and directed by our order of March 29, 1938, pursuant to subsection 77 (c) (11) of the act; and the report thus became by the terms of the same subsection prima facie evidence of the facts therein stated. Accordingly, the report, if in compliance with our order, is not subject to being stricken from the record for failure, as alleged, to state facts as to the cost of reproduction value or accrued depreciation. We find that the report is in compliance with our order, and the motion is overruled.

We have herein computed the claims of secured creditors by adding to the principal unpaid interest thereon to January 1, 1940. The debtor contends, however, that the bankruptcy rule is that in the pro

[11] The debtor's annual report to us (not of record) for the year 1927, the year preceding our authorization of acquisition of the Fort Scott lines, 145 I. C. C. 110, shows no such guaranty.

rata distribution of a bankrupt estate no interest shall accrue on provable claims after the date of bankruptcy. We hold that the debtor is in error as to the applicable rule so far as it affects secured creditors. *Sexton* v. *Dreyfus,* 219 U. S. 339; *Louisville Bank* v. *Radford,* 295 U. S. 555, 597, footnote 30.

(Superseded and obsolete matter is here omitted.)

D. DESCRIPTION AND PROVISIONS OF NEW SECURITIES

(Obsolete matter is here omitted)

2. *First and general mortgage bonds.*—All fixed-interest bonds issued in reorganization, other than the two issues of divisional-mortgage bonds, should be first and general mortgage bonds. The lien of these bonds should be the same as that proposed for the first-mortgage bonds provided in the committees' plan, except that it would also be subject to the liens of the divisional mortgages. The first and general mortgage should contain covenants permitting the extension of the divisional-mortgage bonds without change of lien. The bonds issuable under the first and general mortgage should be unlimited in authorized amount, of which $63,305,149 should be issued in reorganization, in exchange for outstanding securities, and an additional $5,000,000 should be issued to the treasury to provide for contingencies as in the committees' plan.

To promote the maintenance of a continued well-balanced capital structure, the first and general mortgage should provide for a sinking fund requiring application to the retirement of bonds of 50 percent of available net income of the next preceding calendar year, when bonds under the mortgage, plus other funded debt bearing fixed interest, shall exceed either (*a*) 40 percent of total capitalization or (*b*) 55 percent of total capitalization exclusive of funded debt bearing contingent interest. Funded debt and capitalization should be defined for such purposes as including certain guaranties, capitalized rents, and bonds authenticated and delivered, but not included in funded debt as shown on the balance sheet.

To provide for further financing the first and general mortgage bonds should be issuable from time to time in different series, subject to such limitations and restrictions as may be specified in the first and general mortgage, and to such conditions as may be imposed by the Commission or other analogous authority pursuant to provisions of law, payable on such date or dates, in such denominations, bearing interest at such rates, and containing such provisions in regard to the redemption, conversion, taxes, place or places of payment, registration, and sinking funds and such lawful provisions as to money or moneys of payment, and having such other characteristics, as may be prescribed by the board of directors of the reorganized company at the time of issue, but with respect to the lien of the first and general mortgage all equally secured. These provisions are the same as those contained in the conformed plans.

The bonds of series A should be dated January 1, 1940, should mature January 1, 1990, should bear fixed interest at the rate of 4 percent per annum, payable semiannually, and should be redeemable at their prin-

cipal amount and accrued interest, plus a premium of 5 percent of their principal amount if redeemed on or before December 31, 1945, 4½ percent if redeemed thereafter and on or before December 31, 1949, 4 percent if redeemed thereafter and on or before December 31, 1953, 3½ percent if redeemed thereafter and on or before December 31, 1957, 3 percent if redeemed thereafter and on or before December 31, 1961, 2½ percent if redeemed thereafter and on or before December 31, 1965, 2 percent if redeemed thereafter and on or before December 31, 1969, 1½ percent if redeemed thereafter and on or before December 31, 1973, 1 percent if redeemed thereafter and on or before December 31, 1977, and one-half of 1 percent if redeemed thereafter and on or before December 31, 1981, and without any premium if redeemed on or after January 1, 1982. These provisions, as to date, interest rate, maturity, and redemption, are substantially the same as proposed by the three bondholders' committees, except that the committees urge a 40-year term for the bonds instead of a 50-year term. We are not persuaded by the committees' argument that a 4-percent bond of 40-year maturity would have a higher market price than a bond of 50-year maturity, if the interest is reasonably assured of payment, as we are convinced from the record that it is. If the 50-year term would reduce the price of the bonds, the proper corrective would be to issue fewer bonds in reorganization, and not to diminish the term.

While not proposed by the committees, we are of the view that because of the large amount of series-A bonds to be issued in reorganization, a suitable sinking fund of about $200,000 a year should be provided out of net income available therefor, as defined in the order entered herewith.

Provisions should be made for the authentication and issue from time to time of first and refunding mortgage bonds in addition to those authenticated and issued in the reorganization. Such bonds should be issuable for the various corporate purposes and subject to the various limitations provided in the approved plan as shown in the order entered herewith. The principal difference between the approved plan and conformed plans is that the approved plan increases the restrictions in the use of bonds for the purchase of stock. It is believed that this increase is necessary. The approved provisions are similar to those adopted in *Chicago & N. W. Ry. Co. Reorganization*, 236 I. C. C. 575 and 239 I. C. C. 613.

The first and general mortgage of the committees' conformed plans would provide for the issue of $10,000,000 of emergency bonds. The first and general mortgage of the approved plan should contain such a provision. It should also provide for a sinking fund for the retirement of first and general mortgage bonds so long as any emergency bonds are outstanding, such provisions to be similar to those in the first and refunding mortgage of the committees' conformed plans for a sinking fund while emergency bonds might be outstanding under that mortgage. The differences are the result of providing sinking funds on divisional-mortgage bonds in the approved plan not provided in the conformed plans, and differences in the provisions for capital fund hereinafter discussed.

The committees' plan and the committees' conformed plans would provide that no first and general mortgage bonds other than those

to be authenticated under the plan should be sold or pledged unless the board of directors[13] should have determined that it was impracticable to provide on favorable terms the amount of money needed by the sale of income bonds, preferred stock, or common stock. Those plans would also provide for limiting the amount of first-mortgage bonds that might be held in the treasury and the amount of such bonds that might be pledged at any one time over the principal amount of indebtedness so secured. These provisions should be incorporated in the approved plan. The first mortgage of the committees' plan and the first and general mortgage of the committees' conformed plans would also provide for the modification or alteration thereof in certain respects and of the rights and obligations of the reorganized company and the holders of the bonds thereunder at any time by the concurrent vote of not less than 66⅔ percent of the aggregate principal amount of bonds outstanding. This provision should also be included in the first and general mortgage of the approved plan, with a restriction that changes of liens not provided for in the mortgage, or any change not having the prior approval of this Commission, shall not be made under this provision.

3. *Second-mortgage bonds.*—The new second-mortgage bonds should constitute a lien next in order on all property subject to the lien of the first and general mortgage. Subject to State laws and such limits as may be specified in the mortgage, bonds should be issuable without limit as to the aggregate principal amount, and having such characteristics as may be specified by the board of directors with the requisite approval of public regulatory authority, all equally secured. No interest should be mandatorily payable on income-mortgage bonds issued in reorganization (except at maturity or redemption) other than out of available net income. The issue of fixed-interest bonds under the second mortgage should operate to convert contingent interest into fixed interest on all second-mortgage bonds bearing contingent interest. The second mortgage should permit the extension of bonds of prior lien. Such provisions are contained in the conformed plans, except that those plans would not permit the issue of fixed-interest bonds. However, provision for the use of fixed-interest second-mortgage bonds in lieu of bonds of prior lien would appear to be to the advantage of holders of both the junior and senior liens.

Second-mortgage bonds, series A, in the amount of $40,385,885 should be issued in reorganization, dated January 1, 1940, maturing January 1, 2015, and bearing interest at 4½ percent per annum, cumulative up to a maximum amount of 18 percent, redeemable, and convertible into common stock at any time on or before January 1, 1945, at the rate of 30 shares for each $1,000, principal amount, of such bonds and thereafter at the rate of 25 shares for each $1,000, principal amount, of such bonds. These provisions are the same as the provisions of like purpose contained in the conformed plans, except that in the conformed plans the conversion on or before January 1, 1945, would be at the rate of 15 shares and thereafter at the rate of 12½ shares. In view of the limited accumulations of interest, a liberal conversion privilege appears to be called for.

[13] These plans require action by a two-thirds vote. This is modified in the approved plan to lessen danger of default.

The second mortgage should provide for a sinking fund for series-A bonds payable out of available net income of each year in an amount equal to the sum of (*a*) one-half of 1 percent of the maximum principal amount of series-A bonds theretofore at any one time authenticated and uncanceled, plus (*b*) interest on all second-mortgage bonds, series A, then held in the sinking fund. The accruals of the sinking-fund installments should not be cumulative. Such provisions are contained in the conformed plans, appear reasonable, and are approved.

Second-mortgage bonds in addition to those to be issued in reorganization should be issuable from time to time to refund outstanding or redeem pledged second-mortgage bonds, except bonds issued for equipment and bonds acquired by sinking funds, or, in lieu of first and general mortgage bonds, for the purposes and subject to the restrictions stated for first and general mortgage bonds hereinabove, to the extent that first and general mortgage bonds are not issued for such purposes. These provisions are in substance contained in the conformed plans.

The committees' plan and the committees' conformed plans would provide that no second-mortgage bonds other than those to be authenticated under the plan should be sold or pledged unless the board of directors[14] should have determined that it was impracticable to provide on favorable terms the amount of money needed by the sale of preferred stock or common stock. Those plans would also provide for limiting the amount of second-mortgage bonds that might be held in the treasury and the amount of such bonds that might be pledged at any one time over the principal amount of the indebtedness so secured. These provisions should be incorporated in the approved plan. The second mortgage of the committees' plan and conformed plans would also provide for modification or alteration thereof in certain respects, and of the rights and obligations of the reorganized company and the holders of bonds thereunder at any time, by the concurrent vote of not less than 66⅔ percent of the aggregate principal amount of bonds outstanding. This provision, subject to approval by this Commission of any modification proposed, should also be included in the second mortgage of the approved plan. In the event of any unification of the properties of the reorganized company with the properties of any other company, the modification thus authorized might, under the conformed plans and the approved plan, include provisions excluding in whole or in part the earnings from such other properties in determining available net income and providing for the determination of such available net income without the maintenance of separate accounts.

(Obsolete and superseded matter is here omitted)

4. *Preferred stock*—There should be authorized 2,000,000 shares of preferred stock, each of the par value of $100, of which 618,461.69 shares of series A should be issued in exchange in the reorganization as above set forth. The additional preferred stock should be issuable for the purposes, and subject to the restrictions, provided in the conformed plan, except that the consent of holders of two-thirds of the

[14] These plans require action by a two-thirds vote. This is modified in the approved plan to lessen danger of default.

series-A stock should not be necessary to permit issue of preferred stock prior in lien to series-A stock, if the purpose of the issue is one for which mortgage bonds might be issued. In liquidation, the preferred stock should be preferred as to assets to the extent of its par value, accumulated dividends, and any premiums provided. Election of directors should be by cumulative voting. The majority of the board should be elected by the holders of the preferred stock until regular dividends at the maximum rate borne by the preferred stock shall have been paid for 3 successive years, and also at times thereafter under circumstances specified in the order entered herewith. The preferred stock, series A, should be entitled to preferred dividends at the rate of 5 percent, cumulative to the extent that there is net income available therefor. The preferred stock, series A, should be redeemable without premium and convertible into common stock at the rate of 2 shares of common for 1 of preferred. The conversion privilege provided in the conformed plans, at a share-for-share rate, appears inadequate.

Holders of preferred stock, series A, should not have preemptive rights to subscribe to any additional stock or convertible securities.

5. *Common stock*—There should be authorized 5,000,000 shares of new common stock. The 2,700,000 shares provided in the conformed plan is insufficient in view of the requirements of the conversion privileges provided in the approved plan. Of the authorized shares, 1,241,652.62 should be issued in reorganization, and 2,448,499.93 reserved so long as may be required to provide for conversion rights. Holders of common stock should be entitled to 1 vote a share on all matters, except that directors should be elected by cumulative voting and the preferred stock should under circumstances defined above be entitled to elect a majority of the directors, and to elect not less than two directors after default of the equivalent of 6 quarterly dividends.

It should be provided that holders of the common stock in authorizing the issue of additional stock or convertible securities, may waive the preemptive right of all holders of such stock to subscribe to such additional stock or convertible securities. The reorganized company should not, without the consent of both classes of stock, voting separately, (1) create any mortgage or other lien except the new mortgages provided for herein and purchase-money liens on after-acquired property, (2) merge or consolidate or dispose of its assets as an entirety, or (3) make any charter amendments affecting the rights of such stockholders.

The principal characteristics of all the new securities are shown in convenient tabular form in appendix A.

### E. EXECUTION OF PLAN

(Obsolete matter is here omitted)

2. *Payment or assumption of certain claims.*—Of necessity, the following claims, to the extent allowed, should be paid in cash in due course: (*a*) Claims arising from the administration of the trust estate and operation of the property subsequently to the appointment of a receiver on November 1, 1932, (*b*) claims entitled to priority over one or more of the mortgages of the debtor, (*c*) claims

for taxes and special assessments, and (*d*) claims for interest and principal not paid at maturity because not presented for payment. To the extent that such claims are not paid by the debtor or the trustees of the estate of the debtor pursuant to order of the court in the reorganization proceeding, they should be assumed by the reorganized company and paid in cash in due course, provided that any amount so assumed should constitute a charge upon the reorganized company prior in lien to all new securities issued under the new first and general and new second mortgages and, in the case of such amounts having liens prior to the Birmingham bonds of either issue, having also liens prior to the corresponding issue of new divisional-mortgage bonds. All such claims, liabilities, and obligations may be adjusted or compromised and dealt with or paid or discharged by the reorganized company, all as may be determined by the board of directors of the reorganized company subject to approval by the court. We find that the interests of the holders of such claims will not be materially and adversely affected by the plan herein approved. Similar provisions are included in the committees' plan and the conformed plans.

As provided in the committees' plan, and for continuity of operations, the reorganized company should be deemed to have assumed such of the contracts of the debtor which are executory in whole or in part, including any executory leases and liabilities under guaranties, as shall have been affirmed by the bankruptcy trustees in the reorganization proceeding with the approval of the court prior to the date of confirmation of the plan, and also any executory contracts made by the trustees of the estate of the debtor with the approval of the court in the reorganization proceeding which, by their terms, do not terminate at the conclusion of the reorganization proceeding. Such contracts not disaffirmed should be dealt with in the same manner. We find that these claims will not be materially or adversely affected by the plan.

Contracts with the trustees of the estate of the debtor, or the debtor, subject to cancelation, not otherwise provided for in the plan, shall be assumed by the reorganized company so far as may be necessary or desirable as determined by the reorganization committee. We find such contracts not to be materially or adversely affected by the plan.

3. *Miscellaneous provisions.*—(*a*) *Transfer of property.*—The bondholders' committees do not propose any unification of subsidiaries at this time. The debtor proposes that to the extent, if any, that the board of directors shall propose, and the court and the Commission shall approve, prior to the consummation of the plan, the subsidiaries of the debtor shall be eliminated through merger, consolidation, sales of assets, or otherwise, so that all of the properties of the debtor's entire system shall to such extent be consolidated into one corporation. It would appear that in carrying out the plan the reorganization committee should have the power to propose a simplification of the corporate system if that should be found to be desirable. Pending the consummation of the plan, the committee should accordingly have the powers suggested by the debtor for the board of directors.

Except as otherwise provided herein, all property of the debtor should be retained by it or conveyed to a new company as may be

determined by the reorganization committee. As herein used, the term "reorganized company" means the debtor as reorganized or the new company thus acquiring the debtor's property. The reorganized company may be a consolidated company comprising the debtor and any or all of its wholly owned subsidiaries, as shall be determined by the reorganization committee.

(Obsolete and superseded matter is here omitted)

(c). *Notice, confirmation of the plan, sale, etc.*—The plan should contain provisions (1) as to the manner in which any notice required or permitted to be given under or pursuant to the plan shall be given, (2) as to the sale of all or any part of the debtor's property at public auction for the purpose of executing the plan, (3) as to the constitution of the reorganized company's board of directors, the division of the board of directors into classes, and the staggering of the election of directors, (4) as to the power of the court in construing the plan and in curing defects, supplying omissions, or reconciling inconsistencies therein, (5) as to the payment of taxes due the United States from the debtor or trustee for any taxable period prior to the confirmation of the plan, (6) as to the assumption of contracts with the trustee and debtor not otherwise provided for in the plan, and (7) as to the payment of the expenses of reorganization. The provisions of the conformed plans having such purposes appear reasonable and are adopted for the approved plan substantially without change, and in the form shown in detail in the order entered herewith. Provision will also be made for a finance committee, as was made in *Chicago & N. W. Ry. Co. Reorganization, supra*, and for similar purposes.

The provisions herein approved for execution of the plan are approved as being the most equitable and sound financially that can be worked out in the light of conditions as they now exist. They will provide adequate means for the execution of the plan as required by section 77 (b) (5) of the Bankruptcy Act, as amended.

The authorization and approval herein granted by this commission are upon the condition that the journal entries covering the necessary accounting adjustments under the order will be submitted to it for approval before they are recorded on the books of the reorganized company under the plan of reorganization herein approved.

4. *Further authorization by the Commission.*—In view of the provisions of section 77 (f), we shall, when a plan is finally adopted, give consideration to the granting of such authorization for the issue of such securities, and for such sale, consolidation, and merger of the properties, as may be required and proper for the execution of the plan. Nothing contained in this report approving a plan of reorganization should be considered or be construed as a grant of authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation, or merger, or pooling of traffic, pursuant to either the Bankruptcy Act or the Interstate Commerce Act, until further appropriate action by this Commission upon confirmation of the plan by the court.

F. CONCLUSIONS AS TO PLAN

We find that the plan herein approved, which is similar to the committees' conformed plans, with modifications deemed necessary in view of the equities or for practical financial considerations, meets the requirements of section 77 (b) of the Bankruptcy Act, is fair and equitable, affords due recognition of the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, will conform to the requirements of the law of the land regarding participation of the various classes of creditors and stockholders, and will otherwise meet the requirements of section 77 (e), and will be compatible with the public interest.

An appropriate order will be entered.

COMMISSIONER MILLER did not participate in the disposition of this case.

(The appendixes to this report are here omitted)

# INTERSTATE COMMERCE COMMISSION

## FINANCE DOCKET NO. 10008

## ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY REORGANIZATION

*Submitted September 14, 1940. Decided November 16, 1940*

Upon petitions, plan of reorganization for the St. Louis-San Francisco Railway Company approved by division 4 on July 6, 1940, pursuant to section 77 of the Bankruptcy Act, as amended, modified.[1]

Appearances as in prior reports, and also *John G. Lonsdale, Claude E. Hamilton, Jr.*, and *Emmet McCaffery*.

### SUPPLEMENTAL REPORT OF THE COMMISSION

BY THE COMMISSION:

Within the statutory period of 60 days from the date of the order of this Commission, by division 4, of July 6, 1940, 240 I. C. C. 383, approving a plan of reorganization for the St. Louis-San Francisco Railway Company, debtor, pursuant to the act of July 1, 1898, entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States", as amended, petitions for its modification were filed by (1) the debtor, (2) John G. Lonsdale, as one of the trustees of the debtor's estate, (3) Frederick H. Ecker et al., as a committee representing holders of the debtor's consolidated-mortgage bonds, (4) the Chase National Bank of the City of New York and John A. Aid, as trustees under the debtor's consolidated mortgage dated March 1, 1928, (5) John W. Stedman et al., as a committee representing holders of the debtor's prior-lien mortgage bonds, (6) James H. Brewster, Jr., et al., as a committee representing holders of the Kansas City, Fort Scott & Memphis Railway Company refunding-mortgage bonds, (7) Eph A. Karelsen et al., as owners of the Kansas City, Memphis & Birmingham Railroad Company general mortgage and income bonds, and (8) the Reconstruction Finance Corporation, holder of notes of the debtor given under circumstances described in the report of division 4 issued to accompany its order of July 6, 1940. The petitions of the Ecker committee and the consolidated-mortgage trustees are for rehearing on, as well as modification of, the plan approved by division 4. Replies to the petitions for modification, or some of them, were filed by (1) the Ecker committee for holders of consolidated-mortgage bonds, (2) the Stedman committee for holders of prior-lien mortgage bonds, (3) the Brewster committee for holders of Fort Scott refunding-mortgage bonds, (4) the Reconstruction Finance Corporation, and (5) the Railroad Credit Corporation, a creditor.

[1] Prior reports: 207 I. C. C. 623; 221 I. C. C. 199 and 251; 224 I. C. C. 29; 228 I. C. C. 73; 233 I. C. C. 627 and 780; and 240 I. C. C. 383.

By the terms of section 77 (d) of the act we may, after rendering a report and order in which we have approved a plan of reorganization, upon petition for good cause shown filed within 60 days of the date of our order, and upon further hearing if we shall deem necessary, modify in a supplemental report and order any plan which we have approved, stating the reasons for such modifications. The petitions for modification are presented to us upon a record of extensive testimony, argued in voluminous briefs and orally before division 4. We do not deem further hearing necessary on the matters presented by the petitions, and are of the view that the required consideration may be given to the modifications of the approved plan proposed, without further hearings.

In this report we shall confine our observations generally to those matters which were incorrectly decided, or which the petitions indicate were insufficiently discussed, in the prior report.

*Petition of the debtor.*—The debtor contends that the effective date of the approved plan should be changed to May 16, 1933, the date of the filing of the petition for reorganization, and that no allowance should be made for interest accruing after that date. The contention is not sustained. *Sexton v. Dreyfus,* 219 U. S. 339; *Louisville Bank* v. *Radford,* 295 U. S. 555, 597, footnote 30; *Chicago & N. W. Ry. Co. Reorganization,* 239 I. C. C. 613; and other decided cases of this Commission.

The debtor further contends (1) that, in the absence of an allegation by any of the parties to the proceeding that the debtor is insolvent, we are without jurisdiction to enter an order approving a plan which excludes the debtor from participation in the distribution of the securities of the new company; (2) that our prior report and order fails to include a finding of value such as is necessary if the court is to enter an order excluding the debtor or its stockholders from participation; (3) that there is no competent evidence before us to support a finding that the value of the debtor's property, for the purposes of section 77, is less than its debts entitled to recognition in the plan; (4) that the report of our Bureau of Valuation is not such a report as is authorized to be filed, and is of no probative force; and that any prima facie effect it might have, if its filing were authorized, is overcome by the evidence as to investment and other evidence; (5) that we have erred in not finding that the constitutionally protected value of the property exceeds the debts, and in not making a finding of value to aid the court in determining that question and the question whether any value we have arrived at is the constitutionally protected value; (6) that we have erred in treating the earnings record of the debtor as a relevant factor in fixing capitalization, or at any rate in so treating any of the earnings other than those of the predepression period; (7) that we have erred in assigning to the proposed new common stock a value less than the investment value, and in assigning to the new preferred stock a value other than the amount of the preference on dissolution ascribed to it; (8) that so far as capitalization of earnings is taken as material, it is error to use a percentage in excess of 1.88, which is said to be the highest average rate of return on western district class I railroads since 1929; (9) that we erred in allocating $10,000 of new preferred stock to the

holders of the Kansas City, Fort Scott & Memphis preferred stock; and (10) that we erred in the treatment accorded the Reconstruction Finance Corporation and the Railroad Credit Corporation.

As to contention (1), subsection (e) of section 77 provides *inter alia* that the submission of the plan to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value. We consider those provisions to mean that we may find that the stock of the debtor has no equity even if we make no finding that the debtor is insolvent. From our consideration of the evidence of record, we agree with division 4 that the equities of the investors in the common and preferred stocks of the debtor have no value, and that accordingly such holders may be afforded no participation in the reorganization.

*In re Atlas Brewing Co.*, decided by the United States District Court, northern district of Illinois, January 4, 1939,[2] cited by the debtor in support of its contentions, is inapplicable here; and the presumption of solvency of the debtor predicated in that case furnishes no warrant for a like presumption here. There, the plan proposed by the trustee provided that unsecured creditors in the amount of $500 or less should be paid in cash, and unsecured creditors with claims in excess of $500 should receive debentures for their claims, while the holders of defaulted first-mortgage bonds were to be paid in cash the amount of the defaulted bonds, together with secured interest. The court found that the trustee's plan presented in those proceedings was fair, equitable, and feasible; and, such being the case, it was apparent that there was ample room for the presumption of solvency.

Here, after long-continued default, the debtor itself is the proponent of a plan calling upon creditors having the first lien on the great bulk of the property for very drastic sacrifices, incompatible with any supportable claim that the stockholders of the debtor have a continuing interest of value in the property, or are entitled to share in the distribution of the securities of the reorganized company. In the approved plan, division 4 found, and we agree with the finding, that a reasonable capitalization for the reorganized debtor would be $240,000,004, while its present debts, including unpaid interest to January 1, 1940, total no less than $373,977,922. Thus, the new capitalization is sufficient to provide for less than two-thirds of the claims of creditors, and for no part of the claims of stockholders.

We have not in this case, or in any previous case of like character, made a finding of insolvency, although in a large proportion of such cases as this one we have found, as we have found here, that the equities of the stockholders had no value. We hold as to this case that, by the terms of section 77, a finding of insolvency is not necessary in the performance of our duties under the section. See also *In re Western Pac. R. Co.*, 34 Fed. Supp. 493. The necessity of excluding the stockholders in this case from participation in the reorganized company is regrettable, but the necessity is nevertheless compelling, and we

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2 Commerce Clearing House, Inc., Bankruptcy Law Service, third edition, par. 51,564.

approve a plan which accordingly makes no provision for the holders of the outstanding stock of the debtor herein.

The debtor's contentions (2) to (8), inclusive, go to the adequacy of division 4's findings of value considering the requirements of the proceeding. There were included *inter alia* the findings (1) that the average consolidated net railway operating income for the period 1931 to 1938, inclusive, capitalized at 5 percent, is only $74,790,140; (2) that exclusive of the Fort Worth & Rio Grande Railway Company property, which has been sold, the value as of December 31, 1936, on a reproduction less depreciation basis, of roadway, structures, and equipment, plus present value of lands, working capital, and investments in nonsystem companies, was approximately $260,000,000; and (3) that a reasonable capitalization for the reorganized company would be $240,000,000. Capitalized at 1.88 percent instead of 5 percent, average consolidated net railway operating income for the period 1931 to 1938 would produce less than $200,000,000. The record clearly justifies consideration of the earnings during this period. The finding as to reproduction value was based on a report of our Bureau of Valuation, made of record in the proceeding pursuant to section 77 (e) (11), the probative force of which, in our view, is not overcome by the debtor's investment account.

On the contrary, the valuation report in our view serves to establish the infirmities of the investment account following the reorganization of 1916, a matter over which we had no jurisdiction. These infirmities were early recognized in our previous security cases. In *St. Louis-S. F. Ry. Co. Securities*, 79 I. C. C. 323, decided May 8, 1923, division 4 said that the debtor was a reorganization of the St. Louis & San Francisco Railroad Company; that it appeared that at the time of the reorganization the book value of road and equipment was substantially marked up to offset securities issued; and that it appeared that subsequently the book value of road was increased in a substantial amount for the purpose of setting up accrued depreciation on equipment. In *St. Louis-S. F. Ry. Co. Securities*, 86 I. C. C. 818, decided April 29, 1924, division 4 cited the foregoing and said, further, that the final valuation of the debtor's property had not yet been ascertained, that therefore its capitalization could not be compared with the underlying value, and that nothing contained therein was to be taken as an expression of opinion with respect to, or as a determination of, such value. It added that for this reason, pending the final valuation of the debtor's property, it was of the opinion that too great weight should not be given to the amount of capitalizable assets in excess of capitalization as indicating the margin of uncapitalized assets. These findings were affirmed in *St. Louis-S. F. Ry. Co. Securities*, 99 I. C. C. 511, decided July 31, 1925, and in *St. Louis-S. F. Ry. Co. Bonds*, 150 I. C. C. 139, decided December 20, 1928.

In *St. Louis-S. F. Ry. Co.*, 41 Val. Rep. 139, division 1 found that the books of the St. Louis-San Francisco Railway Company recorded an investment in road and equipment on June 30, 1918, of $249,403,243, which if adjusted as suggested by our Bureau of Valuation would become $235,969,564. Of this amount, $14,857,730 represents recorded money outlay and the remainder consists mainly of securities issued or assumed, or other stated liabilities. The cost of reproduction new

of the common-carrier property owned and used by the St. Louis-San Francisco Railway Company, exclusive of lands and rights therein, on June 30, 1918, was found to be $147,571,257, and the cost of reproduction less depreciation $113,650,248. The value of the common-carrier lands owned and used was $14,764,180; that of rights in public domain owned and used was $295,554; and that of rights in private lands owned and used was $2,525. The value for rate-making purposes of the property of the St. Louis-San Francisco Railway Company owned and used for common-carrier purposes was found to be $139,670,000 and of property owned but not used $271,404. The total final value for rate-making purposes of the properties of the various carriers embraced in the proceedings and used by the respective carriers for common-carrier purposes was found to be $209,446,179.

We find no merit in contentions (2) to (8).

Matters relating to the debtor's contentions (9) and (10) have been sufficiently discussed in the division's report of July 6, 1940. No change will be made in the approved plan in these respects.

The debtor further contends that division 4's conclusion that no more than $240,000,000 in capitalization for its property is justified is wholly inconsistent with the findings in *St. Louis-S. F. Ry. Co. Readjustment*, 138 I. C. C. 505, wherein a readjustment in 1928 of the debtor's capital structure resulting in an increase of $15,354,282, producing a total capitalization at that time of $394,600,295, was approved. However, conditions have changed greatly since that time; and the increase in capitalization brought about an improvement over prior capitalization, since it was provided that (1) preferred stock was to be issued in lieu of a substantial amount of outstanding bonds and the ratio of bonds to stock was thereby to be reduced, and (2) bonds bearing 4½-percent interest was issued in lieu of bonds and notes bearing rates ranging from 5 to 6 percent, producing a reduction in the total interest charges. While the interest rate of 6 percent on the adjustment and income-mortgage bonds, the refunding of which was provided for, was not strictly a fixed charge, the interest on the adjustment bonds was cumulative, and as the interest on both of those classes of bonds was being earned and paid, a reduction from 6 to 4½ percent in the nominal rate of interest was considered a substantial saving to the applicant at the time. No change will be made in the total capitalization of $240,000,004 approved by division 4 for the reorganized company.

(Obsolete matter is here omitted)

*Petition of Ecker committee for holders of consolidated-mortgage bonds.*—Frederick H. Ecker et al., as a committee for holders of the debtor's consolidated-mortgage bonds, contend that the approved plan (1) grants to the Reconstruction Finance Corporation and the Railroad Credit Corporation a preference which is without support either at law or in equity, (2) applies standards of capitalization for the reorganized company that are too drastic, and errs in limiting the participation in the reorganization of the holders of consolidated-mortgage bonds to the new securities issuable in respect of the collateral pledged under the consolidated mortgage, (3) makes material changes without good reason in the terms of the proposed new securities set out in the conformed plan presented by the bondholder's com-

mittees, and (4) improperly allocates new securities to the holders of outstanding Kansas City, Fort Scott & Memphis preferred stock.

(Obsolete matter is here omitted)

With reference to the total new capitalization for which provision is made in the approved plan, the committee asserts that such capitalization is less in this case, in proportion to the average net earnings for the period 1926 to 1939, than in 9 other cases in which plans have been approved by us, although higher than in 2; that average net earnings for the period 1926 to 1939 for each $100 of the new common stock were greater in this case than in 10 other cases, although less than in 1; and that the factor by which average net earnings of the period 1931 to 1939 would have had to be multiplied in order to produce an amount sufficient to pay a dividend of $3 for each $100 of new common stock, and prior charges, was less in this case than in 7 other cases, although greater than in 4. The committee argues from this that there is discrimination against the consolidated-mortgage bonds so gross as to constitute an invasion of the holders' constitutional rights, which, if not corrected, will make it necessary for the court to set aside our action, and the committee is aggrieved that no reason has been given for the alleged discrimination.

However, it is apparent that, unless net earnings of the periods selected by the committee are to be taken as the only criteria of new capitalization, there must be some differences among the several roads in the relation between such earnings and the new capitalization. Moreover, the explanation of any apparent discrimination against the debtor is not far to seek in this instance. The figures which the committee offers as average net earnings of the debtor for the period 1926 to 1939 are the results obtained after applying large adjustments to recorded accounts for supposed excess maintenance, although there is no evidence of, no allegation of, and a presumption of some weight against, any substantial accumulation of deferred maintenance or undermaintenance as of December 31, 1935, the beginning of the period, when earnings were excellent. The amounts of the adjustments are not stated; but apparently an adjustment was applied for each year beginning with 1933. That total net earnings of a period of the extent of 14 years beginning with a fully maintained property should be greatly affected by excessive maintenance, or even affected at all, when earnings throughout most of the period were unsatisfactory, is highly unlikely.

Notwithstanding this, the committee asserts that net earnings of the year 1938, the last year for which earnings are stated in the report of division 4, adjusted for excess maintenance and then multiplied by a factor of 3.27, equal the requirements of the approved plan for a dividend of $3 for each $100 of new common stock, and prior requirements, or $11,331,730. Income available for interest adjusted for excess maintenance in accordance with the committee's views was thus $3,465,361. Actually, such income was $1,241,888; and the ratio between earnings and the amount required for the specified dividend and prior charges was as 1 to 9.12, instead of 1 to 3.27. On the basis of earnings of 1938, the treatment of the debtor in the matter of total new capitalization is thus less drastic than that shown by the committee

for 9 of the 11 other roads selected for comparison by the committee. No change will be made in the plan approved by division 4 in the matter of total new capitalization; and, accordingly, no increase in the participation in reorganization provided in the approved plan for holders of consolidated-mortgage bonds can be made.

The changes made in the terms of the proposed new securities set out in the conformed plan presented by the bondholders' committees, which are said by the petitioners to be made without good reason, are (*a*) the provision of a sinking fund for first and general mortgage series-A bonds, (*b*) the additional mortgage restrictions placed on the issue of bonds after reorganization, (*c*) the more exacting requirements for a capital fund, and (*d*) the provision made for future issue of fixed-interest bonds under the second mortgage.

In view of the large amount of first and general mortgage bonds to be issued in reorganization, we are of the opinion that the sinking fund in question is necessary in order to ensure as nearly as may be that the debt shall be paid at maturity, in accordance with the absolute obligation of the bonds.

The additional mortgage restrictions on subsequent issues of bonds objected to relate chiefly to the issue of bonds in the financing of acquisition of stock of other companies; and the ground of the objection is that the additional restrictions are unnecessary, since this Commission has the power to enforce such restrictions irrespective of the mortgages. In our view, the mortgages afford the proper place for the added restrictions, since the latter are so clearly necessary for the protection of the bondholders that provision for such protection through sound mortgage restrictions, as well as by subsequent act of this Commission, appears proper. The committees' plan would afford no protection against the issue of bonds for the acquisition of speculative stock in enterprises unconnected with transportation, except for the requirement that one-fourth of the purchase price would have to be obtained from sources other than the issue of bonds; and there is no requirement that such one-fourth would have to be in cash. We approve the additional mortgage restrictions to which the committee objects.

(Obsolete matter is here omitted)

*Petition of Chase National Bank and John A. Aid, consolidated-mortgage trustees.*—The Chase National Bank and John A. Aid, as trustees under the debtor's consolidated mortgage dated March 1, 1928, advance substantially the same contentions as does the Ecker committee in respect of the treatment provided in the approved plan for the Reconstruction Finance Corporation, the Railroad Credit Corporation, the Kansas City, Fort Scott & Memphis preferred stock, and the consolidated-mortgage bonds, and in respect of the total new capitalization provided for the reorganized company. For reasons above stated or referred to, no changes will be made in the provisions in question.

*Petition of Stedman committee for holders of prior-lien bonds.*—The petition of John W. Stedman et al., as a committee representing holders of the debtor's prior-lien bonds, raises substantially the same objections to the treatment accorded the claims of the Reconstruction

Finance Corporation and the Railroad Credit Corporation in the approved plan as does the petition of the Ecker committee. Such contentions have been considered and disposed of hereinabove. No change will be made.

(Obsolete matter is here omitted)

The committee further objects to (1) the sinking funds provided in the approved plan for fixed-interest bonds, (2) certain of the provisions for the capital fund, (3) the rates provided for conversions of securities, (4) the provisions for issue of fixed-interest bonds under the second mortgage, (5) the provisions in regard to accounting adjustments in the determination of available net income, (6) the provision prohibiting the making of retirements of debt and additions to property through the application of net income the basis for the issue of any securities other than common stock, and (7) the provision restricting payments of contingent interest to multiples of one-fourth of 1 percent.

Objection (1) is sufficiently considered in the report of division 4 and hereinabove, so far as the first and general mortgage bonds are concerned. The contention as regards the new divisional-mortgage bonds cannot be sustained, in view of the quality of the security and the terms of the outstanding bonds for which the new divisional-mortgage bonds are to be exchanged. No change will be made in the approved plan in either respect.

(Obsolete and superseded material is here omitted)

The approved plan provides that the new second-mortgage, series-A bonds shall, at the option of the holder, be convertible into shares of common stock, as at the time constituted, at any time before January 1, 1945, at the rate of 30 shares for each $1,000, principal amount, of such bonds, and thereafter at the rate of 25 shares for each $1,000 of such bonds; and that the new series-A preferred stock shall be convertible, at the option of the holder, at any time on or before 15 days prior to the date as of which such preferred stock shall have been called for redemption, into common stock as at the time constituted, at the rate of 2 shares of common for 1 of preferred. The par value of the series-A preferred stock is $100 a share. The prior-lien committee contends that these conversion rates should be halved; but the Fort Scott committee urges that they should not be decreased. Although the new common stock is of no par value, each share represents only about $50 of capitalization; and accordingly the conversion rates sought by the committee appear unreasonably low. Those of the approved plan appear reasonable. No change will be made in this respect.

The approved plan provides that available net income shall be ascertained, for each calendar year, as the account shall be stated on the books of the reorganized company when its accounts are closed for such calendar year, without adjustment, except that (1) if in respect of any calendar year the available net income is a deficit, the amount of such deficit shall be carried forward and be deducted in determining available net income for the succeeding calendar year or calendar years until such deficit, or accumulated or remaining deficits, be extinguished by

earnings, which in the absence of such deficit or deficits would be available net income; and (2) debits or credits to adjust income in prior years shall be treated as income items for the year in which entered on the books, whether cleared through income or profit and loss accounts, so far, but only so far, as such debits and credits reflect cash receipts or disbursements in the year in which they are entered on the books. The prior-lien committee urges that, in lieu of such provisions for adjusting available net income, there should be substituted the following:

**Any adjustments necessary to correct the income accounts of any prior year shall be made by appropriate entries which may either be made in the accounts of the current year or, in the discretion of the board of directors of the reorganized company, and subject to the approval of the Interstate Commerce Commission or of such other governmental agency, if any, as at the time may have jurisdiction over the accounting practices of the reorganized company, may be made, in whole or in part, in the accounts of any subsequent year or years, and any such debits or credits made in the accounts of any year to adjust entries in the income accounts of prior years shall be treated as income items for the year in which entered on the books, whether cleared through income or profits and loss accounts.**

The provision for taking deficits of prior years into account, in the determination of available net income and the amounts payable as contingent interest in subsequent years, would make available additional resources from which to replenish the capital fund and working capital to the extent depleted in the deficit years in the payment of fixed charges, and from which to repay any money borrowed in the deficit years for the payment of fixed charges; and in our view the provision should be retained. The provision for treatment of credits to adjust income in prior years as income items for the year in which entered on the books only so far as such credits reflect cash receipts in the year in which they are entered on the books would appear to have the effect of ensuring that contingent-interest charges shall in no event be, as we are of the view that they should not be, an occasion for unavoidable default. However, the provision does not appear indispensable for such purpose; and we are of the opinion, in view of the probable effects of continuous accounting, as between the period of trusteeship and the period of subsequent operations by the reorganized company, that it may safely be eliminated. The provision proposed by the committee as quoted will be substituted for the provision numbered (2) in the approved plan, as just referred to in the preceding paragraph.

The approved plan provides that no retirements of debt or additions to property, through application of net income, shall be made the basis for the issue of any securities, except common stock. The prior-lien committee contends that, because of the difficulties of compliance therewith, this provision should be eliminated. The approved plan will be changed accordingly.

The approved plan provides that payments of contingent interest shall be made only in multiples of one-fourth of 1 percent. For greater convenience, and as urged by the prior-lien committee, this provision will be changed so as to provide that payment of contingent interest shall be made only in amounts equal to or greater than one-fourth of 1 percent.

(Obsolete material is here omitted)

*Petition of Brewster committee for holders of Fort Scott bonds.*—James H. Brewster, Jr., et al., as a committee representing holders of the Kansas City, Fort Scott & Memphis Railway Company refunding mortgage bonds, contend in their petition (1) that the provisions of the approved plan for a capital fund should be modified so that in conjunction with any other order its provisions may not be interpreted as requiring charges for depreciation of roadway and structures; and so that, in lieu of the requirement that any payments into the fund in excess of the amount necessary to maintain a balance of $1,125,000 in the fund shall be used for additions and betterments or retirements of debt, payments into the fund shall be limited to the amounts necessary to maintain a balance of $1,125,000 in the fund after withdrawals for the purposes specified in the committees' conformed plan; (2) that the provisions permitting issue of fixed-interest bonds under the second mortgage should be eliminated; (3) that the sinking fund provided for first and general mortgage series-A bonds should be eliminated, or should cease to operate when the relative proportions of fixed-interest bonds and fixed charges shall no longer be large; and (4) that the provisions for issue of voting-trust certificates should be eliminated; that express provision should be made for cancelation of first and general mortgage bonds redeemed from pledge through refunding, by issue of first and general mortgage bonds, of obligations secured by first and general mortgage bonds; and that the provisions for calculation of interest on second-mortgage series-A bonds held in sinking fund should be clarified.

(Obsolete material is here omitted)

We are of the view, for the reasons indicated, that the provisions of the approved plan for a capital fund as above modified should not be further modified. The contention that the provision of the approved plan permitting issue of fixed-interest bonds under the second mortgage should be eliminated has been sufficiently discussed hereinabove. The contention that the provisions for a sinking fund for first and general mortgage series-A bonds should be eliminated has been already sufficiently considered herein. That provision should be made for cessation of operation of the fund, when the proportion of fixed-interest debt and fixed charges shall no longer be large, appears undesirable, in view of the fact that the operation of the fund throughout the entire term of the series-A bonds will not necessarily retire more than one-sixth of the total of such bonds to be issued in reorganization.

As urged by the committee, the provision for issue of voting-trust certificates will be eliminated; express provision will be made for the cancelation of first and general mortgage series-A bonds redeemed from pledge under the circumstances above described; and the provision for calculation of interest on second-mortgage series-A bonds held in sinking fund will be clarified.

(Obsolete material is here omitted)

In its reply, the Brewster committee (1) opposes the suggestion of Lonsdale, trustee of the debtor, as to the designation of the membership of the reorganization committee, and the constitution of the mem-

bership thus designated as voting trustees, (2) opposes the contentions of the Stedman committee that the amounts of new common stock issuable upon conversion of the new income bonds and new preferred stock should be decreased, (3) urges that, if the approved plan is modified in accordance with the contentions of the Stedman committee that the question of the proper treatment of the claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation should be submitted to the court for determination without resubmission to this Commission, it should be expressly stated in the approved plan as thus modified that any burden, or any part of any such burden, of any priority recognized by the court should not be made to fall upon the holders of the outstanding Fort Scott bonds, and (4) joins in those contentions presented by both the Ecker and Stedman committees which are not inconsistent with its own contentions. These matters have been sufficiently considered hereinabove, and our conclusions indicated.

(Obsolete material is here omitted)

*Conclusions.*—We conclude:

1. That, upon the petitions filed, the plan of reorganization for the St. Louis-San Francisco Railway Company, approved July 6, 1940, pursuant to section 77 of the Bankruptcy Act, as amended, should be modified as follows, and that as thus modified the plan will meet the requirements of section 77 (b) and (c) of the Bankruptcy Act, will be compatible with the public interest, and should be approved:

(*a*) The following provision with respect to the designation of members of the reorganization committee should be added, and provisions inconsistent therewith should be eliminated:

**The reorganization committee shall be composed of three members who shall carry out the plan under the supervision and control of the court. One of such members shall be designated by the prior-lien bondholders' committee, one by the Kansas City, Fort Scott & Memphis Railway Company bondholders' committee, and one by the consolidated-mortgage bondholders' committee.**

(*b*) The following provision as respects second-mortgage bonds should be added, and provisions inconsistent therewith should be eliminated:

**The second-mortgage bonds, without limit as to aggregate amount or within such limit as may be specified in the second mortgage, or prescribed by the laws of the States in which the reorganized company shall be incorporated, may be issued from time to time in different series, subject to such limitations and restrictions as may be specified in the second mortgage, payable on such date or dates, in such denominations, bearing interest at such rates, and containing such provisions in regard to accumulation of interest, redemption, conversion, taxes, place or places of payment, registration and sinking funds, and such lawful provisions as to money or moneys of payment, and having such other characteristics, as may be prescribed by the board of directors of the reorganized company at the time of issue, with requisite approval of public regulatory authority, but with respect to the lien of the second mortgage all equally secured. No interest shall be mandatorily payable on second-mortgage bonds (except at maturity or redemption) other than out of available net income, as hereinafter provided.**

(*c*) The provision in that part of the approved plan dealing with second-mortgage bonds that, in the event that any series of second-mortgage bonds bearing fixed interest shall hereafter be issued, then and in that event the interest on the series-A convertible income bonds

shall become fixed and all arrears of accumulated interest shall become immediately due and payable, should be eliminated.

(Obsolete and superseded material is here omitted)

(*h*) The following provision, with regard to the ascertainment of available net income, should be added, and provisions inconsistent therewith should be eliminated:

Available net income shall be ascertained, for each calendar year, as the account shall be stated on the books of the reorganized company when its accounts are closed for such calendar year, without adjustment, except that (1) if in respect of any calendar year the available net income is a deficit, the amount of such deficit shall be carried forward and be deducted in determining available net income for the succeeding calendar year or years, until such deficit, or accumulated or remaining deficits, be extinguished by earnings which, in the absence of such deficit or deficits, would be available net income; and (2) any adjustments necessary to correct the income accounts of any prior year shall be made by appropriate entries which either may be made in the accounts of the current year, or, in the discretion of the board of directors of the recognized company, and subject to the approval of the Interstate Commerce Commission or of such other governmental agency, if any, as at the time may have jurisdiction over the accounting practices of the reorganized company, may be made, in whole or in part, in the accounts of any subsequent year or years, and any such debits or credits made in the accounts of any year to adjust entries in the income accounts of prior years shall be treated as income items for the year in which entered on the books, whether cleared through income or profit and loss accounts.

(*i*) The provision in that part of the approved plan dealing with the determination and application of available net income, that no retirements of debt or additions to property through the application of net income shall be made the basis for the issue of new securities except common stock, should be eliminated.

(*j*) The following provision with respect to the determination and application of available net income should be added, and provisions inconsistent therewith should be eliminated:

No contingent interest will be required to be paid if the amount so paid would be less than one-fourth of 1 percent; and all payments will be in an amount equal to or greater than one-fourth of 1 percent.

(*k*) The provision in that part of the approved plan dealing with the treatment of existing securities and claims that voting-trust certificates shall be issued in lieu of stock certificates pending termination of a voting trust should be eliminated.

(*l*) The following provision should be added, and provisions inconsistent therewith should be eliminated:

First and general mortgage bonds, in addition to those to be authenticated in reorganization, may, with the requisite approval of public regulatory authority, be authenticated from time to time (*a*) to refund the Birmingham divisional bonds, or first and general mortgage bonds (excluding bonds issued for equipment, bonds issued solely by way of pledge or acquired by sinking funds, and emergency bonds, as hereinafter defined, except as hereinafter provided), or outstanding obligations secured by first and general mortgage bonds to the extent such bonds are redeemed from pledge thereby and canceled or obligations secured by prior lien on after-acquired property or obligations of other companies all the capital stock of which shall be owned and pledged under the first and general mortgage; or (*b*) upon the deposit therefor of cash equal to the principal amount to be issued except cash deposited in lieu of mortgaged property sold, and except cash for the capital fund; or (*c*) to provide for, or to reimburse the new company for, not exceeding 75 percent of expenditures for additions to, extending, or improving the mortgaged estate made after December 31, 1939, but not more than 3 years prior to the date of such authentication (including

expenditures for the acquisition or construction of new railroad equipment, free from other lien, but not including expenditures for the making of additions and betterments to equipment) which, under the accounting rules of the Commission or other Federal regulatory bodies having jurisdiction in the premises, at the time in force, are properly chargeable to capital account; provided, however, that * * * [the provisos will be the same as in the plan as approved by division 4].

(*m*) The following provision should be added, and provisions inconsistent therewith eliminated:

The second mortgage shall provide for the payment on May 1 of each year while any second-mortgage bonds, series A, are outstanding, of an installment of sinking fund, if earned, as, and in the amount hereinafter specified. Such installment shall be payable only out of available net income for the last preceding calendar year that remains after paying interest on outstanding second-mortgage bonds. The amount of such installment shall equal (*a*) one-half of 1 percent of the maximum principal amount of second-mortgage bonds, series A, theretofore at any one time authenticated and uncanceled, plus (*b*) an amount equal to interest on all second-mortgage bonds, series A, then held in the sinking fund, calculated at the rate, not to exceed 4½ percent, paid as current interest on outstanding bonds in respect of available net income of the calendar year next preceding the said May 1.

2. That, except as the plan shall be modified in accordance with the foregoing, the said petitions for its modification should be denied.

An appropriate supplemental order will be issued.

LEE, *Commissioner*, concurring in part:

Approval of the claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation for special equities accords these claimants' clear priority over the treatment to which they are entitled by virtue of the collateral security held by them. Thus the rights of the holders of bonds issued under the debtor's prior lien and consolidated mortgages are subordinated to such special equities, although not all of the holders of such bonds agreed to the plan which is assigned as the basis for such treatment. Without doubt some of them had no knowledge of the proposed arrangement.

I do not agree that under these circumstances the rights of holders of such bonds should, without their consent, be so subordinated. In all other respects I approve the report.

COMMISSIONERS MILLER, ROGERS, and JOHNSON did not participate in the disposition of this case.

(The appendix to this report is here omitted)

# INTERSTATE COMMERCE COMMISSION

## FINANCE DOCKET No. 10008

## ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY REORGANIZATION

*Submitted March 27, 1944. Decided July 4, 1944*

Upon return by the court of jurisdiction for reconsideration, plan of reorganization of the St. Louis-San Francisco Railway Company, pursuant to section 77 of the Bankruptcy Act, as amended, further modified and approved.[1]

*William V. Hodges* for debtor.

*Edwin S. S. Sunderland, Thomas O'G. Fitzgibbon, Judson C. McLester, Jr., Henry W. Anderson, George D. Gibson, Robert T. Swaine,* and *Leonard D. Adkins* for bondholders' committees.

*Fitzhugh McGrew, Alexander M. Lewis,* and *Orville W. Wood* for mortgage trustees.

*A. L. Reed* for self.

*John E. Westerlund* and *Henry Oetjen* for interested parties.

### REPORT OF THE COMMISSION ON FURTHER CONSIDERATION

BY THE COMMISSION:

By supplemental report and order herein of November 16, 1940, 242 I. C. C. 523, we approved a modified plan of reorganization for the St. Louis-San Francisco Railway Company, debtor, pursuant to the act of July 1, 1898, entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States," as amended. The plan as thus approved was certified, pursuant to subsection 77 (d) of the act, together with a transcript of the proceedings before us and a copy of the report and order approving a plan, to the court of jurisdiction, the District Court of the United States for the Eastern District of Missouri, Eastern Division. The court having considered, on the record made before us and the subsequent record made before it, objections filed with it by parties in interest, to the modified plan, directed the return of that plan to us by opinion and order dated July 25, 1942, for reconsideration pursuant to its conclusions stated in the opinion, and in the light of the controlling opinion of the Supreme Court should one be handed down in one of the other reorganization proceedings dealing with matters similar to the objections of the debtor in this proceeding.

Notices of appeal from the district court's order of July 25, 1942, were filed by the Reconstruction Finance Corporation and the Railroad Credit Corporation; and in a further order, that part of the order of July 25, 1942, directing that the record of the court and all

[1] For previous reports see 249 I. C. C. 195 and 252 I. C. C. 818.

papers forwarded by the Commission to the court be returned to the Commission, was stayed. The subject matter of the appeals was thereafter compromised and the appeals were dismissed by the Circuit Court of Appeals for the Eighth Circuit. On December 2, 1943, the district court dissolved the stay of part of the order of July 25, 1942; and directed that the plan, together with the record and papers, be returned to the Commission to be reconsidered in accordance with the opinion and order of July 25, 1942.

A hearing before the Commission has been held pursuant to the court's orders of July 25, 1942, and December 2, 1943; and briefs have been filed.

The district court in its opinion and order of July 25, 1942, found that the priorities given to the claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation in the plan previously approved by the Commission could not be sustained on the ground that there were special equities arising in their favor out of the lending of the money in 1932 and the character of its use. Pursuant to order of the court of October 14, 1943, approving the settlement above referred to, the debtor's trustees purchased, for sums of cash determined by negotiation and compromise, the total of these claims. Provision was made in the order for subrogation, of those entitled, to the liens and benefits of the collateral, to the end that their respective rights and interests may be fully protected in any marshalling of the assets of the debtor corporation or in the distribution of any securities that may be issued under any reorganization plan or otherwise for or against the collateral or for the cash used in the acquisition thereof. The plan approved herein will conform to these requirements.

The court also found that the claims on the 100 outstanding shares of preferred stock of the Fort Scott company cannot properly be disposed of in the manner we proposed. An additional proceeding before the court for the purpose of establishing the rights of the holders is found by the court to be required. The claim is a relatively small one, which it appears can readily be disposed of in the manner found to be appropriate by the court, by payment of all or part of it in cash, or by an allotment of an amount of new securities which will not greatly increase total capitalization beyond the approximate limits we shall approve therefor. The plan herein approved will conform to the ruling of the court.

The above are the only changes in the previously approved plan required by order of the court. In addition, the court suggested that, since the plan was to be referred back to the Commission for reconsideration, further consideration be given at the same time to (1) a later effective date than January 1, 1940, (2) the objections of the debtor as to new capitalization in the event of the Supreme Court's subsequently handing down an opinion dealing with them, (3) prospective earnings, (4) unusual amounts expended for the upbuilding and maintenance of the road during the time it was in receivership and trusteeship, (5) allotment to the holders of Birmingham Bonds of a new bond which could be sold on the market for par, and (6) the setting forth in the new plan of appropriate machinery with reference to the reorganization managers and the naming of the first board

of directors, and if necessary provision for a voting trust. Consideration of question (5) is no longer necessary since the Birmingham bonds have been retired. The other questions will be hereinafter considered.

*Proposed new plans.*—The Brewster, Stedman, and Ecker committees representing respectively holders of Fort Scott, prior-lien, and consolidated-mortgage bonds, filed jointly a new plan of reorganization, proposed February 16, 1944, hereinafter called the bondholders' plan. The corporate trustee of the Fort Scott bonds has no objection to the bondholders' plan and the corporate trustees of the prior-lien and consolidated-mortgage bonds, respectively, consider the plan fair and equitable to the holders of bonds for which they are trustees. The only opposition to the bondholders' plan, or any of its provisions, was presented by the debtor, which filed a statement of proposed modifications of the bondholders' plan.

Except for matters of mere order or arrangement, the bondholders' plan differs so little from the plan approved herein, and set forth at length in the order entered herewith, that reference will be made in this report only to those provisions in which it differs from the plan we shall approve, and to those provisions which, although approved, appear to require discussion.

The debtor's proposed modifications are hereinafter discussed.

*Present capitalization and secured claims.*—Capitalization as of December 31, 1943, was as follows:[2]

| | |
|---|---|
| Equipment obligations, class 1 | $ 2,986,000 |
| Collateral-trust bonds | 1,000 |
| Fort Scott bonds, class 2 | 25,835,000 |
| Prior-lien bonds, class 3 | 117,448,597 |
| Consolidated-mortgage bonds, class 4 | 118,305,000 |
| Loans, class 5 | 5,136,864 |
| Preferred stock, class 9 | 49,158,300 |
| Common stock, class 10 | 65,543,226 |
| Total | 384,413,987 |

Included in the above are $269,712,461 of secured creditors' claims, exclusive of unpaid interest. Interest in default on the claims mentioned as of December 31, 1943, was in the amount of $96,317,924, making the total of such creditors' claims $366,030,385. A total of securities issued or assumed plus cash distributed in consummation of the reorganization would thus have been required in the latter amount for satisfaction of creditors' claims as of December 31, 1943, before any provision for stockholder participation could have been made.

The debtor argues on brief that it would require a modification of the bankruptcy law to permit a creditor to claim against the general estate and have the earnings of his security during administration; and that it would be a distinct concession to him of a dubious right. As to legal interest accrued but not earned during administration (some

[2] Classification in accordance with court order No. 399-A dated April 20, 1944. Classes 6, 7, and 8 embrace priority claims and claims of general creditors.

$60,481,680 [3] in this case according to the debtor), the debtor argues that creditors have no legal right. We found in 240 I. C. C. 383, 424 that there were no free assets in the debtor's estate; and nothing is included in the above-stated amounts of present capitalization and claims for interest at the legal rate [4] in excess of interest at coupon rates, or for interest on unsecured claims. We hold that under the circumstances interest in default as above stated must be considered as a part of the claims of secured creditors. *Sexton* v. *Dreyfuss*, 219 U. S. 339; and *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 597, footnote 30.

The debtor further asserts, in its proposals for modifications, that it is desirable that before any plan is put in final form, the trustees in reorganization negotiate a settlement of the bank claims to the end that the collateral held by the various banks may be released and canceled. It also urges that the present rights to deduct from income approximately $12,000,000 annually, before the incidence of Federal income and excess-profits taxes, should be preserved for the reorganized company to the maximum extent, through the use of interest-bearing securities.

*Proposed new capitalization.*—In our prior reports we approved a total new capitalization of $240,000,004, comprising $75,685,319 of fixed-interest obligations, $40,385,885 of contingent-interest obligations, $61,846,169 of preferred stock, and $62,082,631 of common stock. The Court suggested that in connection with these findings further consideration be given to (*a*) the objections of the debtor, in event of the Supreme Court's subsequently handing down an opinion dealing with them, (*b*) prospective earnings, and (*c*) unusual amounts expended for the upbuilding and maintenance of the road during the time it was in receivership and trusteeship. The bondholders in their plan propose a total new capitalization of $247,838,808, comprising $76,371,342 of fixed-interest debt, $47,549,826 of contingent-interest debt, $61,859,782 of preferred stock, and $62,057,858 of common stock.

We shall consider the questions here presented, as all others, mindful of and in the light of the controlling doctrines announced by the Supreme Court.

Among the debtor's proposed modifications are that creditors receive bonds and shares in the reorganization to represent a present in-

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[3] Also referred to by debtor as interest at contract rates. The $60,481,680 increased by $9,490,028 of interest accrued prior to May 16, 1933 and $26,346,214 of interest accrued but not paid after May 16, 1933, as indicated in the schedule attached to the debtor's plan, add up to $96,317,922 as compared with interest in default in the amount of $96,317,924.

[4] Loans from the six banks totaling $4,500,000 were made at 4 percent interest in January and February of 1931, due in July and August of that year. In connection with later bond financing, of July 1931, those notes were surrendered for new notes at 6 percent, dated July 1, 1931, and due January 1 (renewable to July 1) and July 1, 1932. An additional loan of $1,474,722 was made by the Chase National Bank of July 1, 1931, at 6 percent interest. On November 1, 1932, when James M. Kurn was appointed receiver, a total principal amount of $5,136,863.62 was outstanding on the loans from the six banks, all carrying 6-percent interest and all overdue from July 1, 1932, except the loan from the Chase National Bank, which was due December 31, 1932.

debtedness of $302,561,703,[5] exclusive of equipment-trust obligations which as of January 1, 1944, were in the amount of $2,986,000; and that creditors thus be given on account of their claims $6,500,000 in cash, $240,000,000 in bonds and preferred stock, and 70 percent of a suitable issue of common stock, of which the remaining 30 percent would be allotted to the debtor for distribution to holders of its outstanding preferred and common stock in accordance with their respective rights.

The debtor's proposals would require as a minimum, a new capitalization of $420,043,407,[6] exclusive of any securities it might be necessary to allot to creditors as compensation for loss of priority, and assuming no distribution of cash to creditors, and taking any new no-par stock at book value. A distribution of cash in consummation of the plan would reduce the amount of new capital required to satisfy creditors' claims under the debtor's proposal. The bondholders in their plan propose a cash distribution of $6,585,823, or in round figures $7,000,000, which is 70 percent of $10,000,000. With such a cash distribution, the debtor's proposals would thus require a new capitalization of at least $410,043,407. Even a cash distribution in an amount double the sum proposed by the holders would require a new capitalization of over $400,000,000.

The debtor in its proposed modifications of plan of reorganization asserts that giving full consideration the burden of governmental policies and directives affecting rates, operating expenses, and taxes which the debtor has experienced, the earning power of the debtor's property is sufficient to permit an average annual distribution from income of more than $13,000,000 for interest and dividends during any period of national and regional business activity, not subnormal, in which it has rendered its transportation service. The sum mentioned capitalized at 5 percent produces $260,000,000.

However, the debtor argues, on brief, that money and property paid into a corporation may be lawfully capitalized; that Congress has not yet given any agency authority to limit the capitalization of the debtor to an aggregate of less than what would be lawful under the laws of Missouri; that if Congress should think that it is in the public interest to do so, it would require the exercise of a legislative power not delegable to any administrative commission; and that there need be no occasion for the capitalization of the reorganized debtor at any less amount than that at which it could be lawfully capitalized under the Missouri law. To the extent that this is a contention that we may not approve a plan of reorganization in this proceeding providing for a reduced capitalization, or providing for a capitalization less than that urged by the debtor, it is not sustained.

Applying those theories, the debtor contends for a new capitalization of $400,000,000, basing its computation on the consolidated general balance sheet as of December 31, 1943. It insists that balance

[5] The total of secured creditors' claims, as of December 31, 1943, including the $2,986,000 of equipment obligations and interest in default, was, as stated, $366,030,385. The amount stated by the debtor as present indebtedness does not include interest accrued but not earned during the trustees' operation.

[6] The total of creditors' claims as of December 31, 1943 was, as stated, $366,030,385. The excess of the latter sum over $240,000,000 is $126,030,385, which is 70 percent of $180,043,407. The latter added to $240,000,000 produces $420,043,407.

sheet supports a new capitalization of $397,000,000; and that by the end of the first 6 months of 1944, cash accumulations will make up the difference of $3,000,000. In addition to the balance sheet, the debtor refers to reproduction estimates which it introduced in evidence before the special master, and to certain evidence on the subject of prospective earning power.

The $397,000,000 in question was arrived at by deducting from total assets, which were in the book amount of $482,366,554.64 as of December 31, 1943, the sum of current liabilities and unadjusted credits, which was in the book amount of $85,350,655.91 as of the same date. The result is variously termed by the debtor as net investments and net assets exclusive of the claims of secured creditors. Existing capitalization as of that date was, however, in the amount of $384,413,986, of which $114,701,526 represented capital stock and $269,712,460 represented funded debt. The debtor thus contends for a substantial increase in capitalization, instead of the reduction normally resulting from a reorganization of this character.

Moreover, the existing capitalization, stated on the books as $384,413,986, was subject to a deficit balance in surplus account amounting to $83,917,824; and the book value of stocks and bonds representing existing capitalization, or the unimpaired capitalization, was thus only a little more than $300,000,000. On the other hand, no dividends had been paid on preferred or common stock for many years, and while funded debt was in an amount no greater than $269,712,460, interest in default amounted to no less than $96,317,924. Thus the balance on which the debtor relies for a computation of new capitalization of $400,000,000, shows a failure, by some $96,317,924, during the preceding period when dividends were omitted, to service even $269,712,460 of the debtor's existing capitalization of $384,413,986. The balance sheet in our view does not justify a new capitalization of $400,000,000, or even of $269,712,460, the amount of the funded debt.

The new capitalization of $400,000,000 urged by the debtor is not, if rebuttal testimony be disregarded, beyond limitations consistent with reproduction estimates adduced by witnesses for the debtor at hearings before the special master. Indeed a substantially higher capitalization would not be precluded by these estimates, if testimony of the debtor's witness as to a fair allowance for the going-concern value of the property were accepted. In our prior report in 240 I. C. C. 383, 400, we found the cost of reproduction less depreciation, plus the value of lands and rights and an allowance for working capital, for the properties of system companies as of December 31, 1936, was $256,019,391.[7] From December 31, 1936 to December 31, 1943, there was a net decrease in investments in road and equipment of $4,192,375.

No determination of the differences between the estimate approved by us and the estimates relied on by the debtor was made by the court or the master. The debtor's witnesses failed to deduct for depreciation

[7] Cost of reproduction new figures were based on revised inventories as of December 31, 1934, with consideration given to subsequent changes in property items as disclosed by the carrier's records for 1935 and 1936. Period prices were applied, determined from consideration of records of prices and their individual trends prevailing in 1936 and during a period of time prior and subsequent thereto. Cost of reproduction less depreciation was determined in accordance with methods frequently explained in the valuation reports of the Commission.

tion of roadway accounts, which was, in our view, an error; and the estimate of going-concern value appears unreasonable. But a detailed examination of the other differences between the estimates would be time consuming and would delay disposition of the case by weeks if not by months. In our opinion, such an examination is not essential to a determination of appropriate new capitalization in this proceeding, since without disregarding the reproduction estimates, new capitalization may be found by more direct methods through consideration of all relevant evidence, and particularly of the evidence as to prospective earnings. And the record of the property after nearly 12 years in the custody of the court would seem to make it clear that an increase in capitalization would be unreasonable and that a substantial reduction in capitalization is required.

In our prior report in 240 I. C. C. 383, 404, we stated the amounts of consolidated income available for payment of interest from 1928 to 1938, as shown by the books of account, and as adjusted in particulars mentioned. Consolidated income available for fixed charges, as shown by the books for the years 1939 to 1943 was as follows[8] (fixed charges other than interest in no case exceeding $40,212):

| | |
|---|---|
| Year 1939 | $ 3,942,422 |
| Year 1940 | 5,388,733 |
| Year 1941 | 12,481,121 |
| Year 1942 | 27,270,245 |
| Year 1943 | 24,049,148 |

The average as shown by the books for the last 16 years is thus $10,684,401, a sum, which capitalized at 5 percent, would produce a capitalization of $213,688,020; and the average for the last 12 years is $7,928,430, a sum which, capitalized at 5 percent, would produce a capitalization of $158,568,600.

The debtor insists that the prospective earning power of the railroad is not determinable within any reasonable degree of accuracy. We do not share that view.[9] Despite any misgivings on that score, however, the debtor presented a witness who adduced an estimate of future operating results based on the 28-year period 1916 to 1943.[10]

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[8] The stated amounts are reported income. If the plan now proposed by the bondholders had been consummated and in effect on January 1, 1940, the reported income would have been much less for the years 1941 to 1943 owing to the reduction in interest charges proposed in the plan, which would have increased income taxes. The debtor presented a statement intended to show the distribution under the bondholders' plan of reported income for the 4-year period 1940 to 1943 and for the year 1943 separately without, however, taking into account the changes in taxes that the plan would have brought about. This is urged by the debtor as a demonstration of corporate earning power. However, even if correctly determined, a showing of how earnings are distributed adds nothing to the probative force of the earnings thus distributed, so far as the question of new capitalization is concerned.

[9] The term "earning power," as we have used it, means capacity to produce income available for fixed charges as defined in our classification of accounts. A fair definition of "earning power," in the operation of the debtor, would not make deduction for income and excess-profits taxes.

[10] The debtor urges in particular consideration of its earnings from 1921 to 1930. Such earnings appear to be amply taken into account in the estimate referred to. The debtor also insists that its gross earnings of the depression period are wholly insignificant in determining its earning power. The witness did not so testify, nor are we of that view.

His estimate, which he believed conservative, for the average year following the present war is $73,000,000 of revenues ($66,000,000 of freight revenues and $7,000,000 of passenger revenues), $49,000,000 of operating expenses (based on an operating ratio of 67 percent), and $9,000,000 of taxes. Disregarding hire of equipment, joint-facility rents, nonoperating income, and deductions from income, as to which the witness did not present an estimate, this would leave $15,000,000 available for interest, a sum which, capitalized at 5 percent would produce a capitalization of $300,000,000. This is an amount far short of the total of creditors' claims, and far short of such total reduced by an amount equal to all cash available for distribution in reorganization.

Moreover, to bring the estimate down to a point where a capitalization of no more than $250,000,000 would be justified, it would only be necessary to forecast an operating ratio of 70.55 percent, where the witness has estimated 67 percent. And in point of fact the ratio of 67 percent, or any ratio lower than 70.55 percent, has little to support it in past experience. The witness testified that the operating ratio average 79 percent during the period of 1918 to 1919; 73 percent during the period of 1920 to 1929; and 67 percent during the period of 1941 to 1942. For the period 1930 to 1939, operating expenses as stated by the witness were 82 percent of operating revenues as similarly stated. Operating efficiency has been increased and unprofitable mileage abandoned; but the extent to which the cost of labor and materials will rise when wartime controls are lifted was not estimated by the witness. This evidence is not convincing that a new capitalization of more than $240,000,000 to $250,000,000 is warranted.

In addition to the evidence above mentioned, the debtor presented the testimony of economists relative to the post-war national income that may be expected, and the relation of the debtor's revenues to such income. Studies were made of the ratios borne in past years (1) by the revenues of the debtor to the total of revenues of all class I railroads, and (2) by the total of the revenues of all class I railroads to the national income. Mean ratios for application to forecasts of national income in predicting the debtor's revenues were thus obtained. As a basis for computation, one of the witnesses, assuming a high level of employment after the war, adopted an estimate of $120,000,000,000 as the post-war national income; and produced the result of $86,400,000 as the probable post-war revenues of the debtor's system. Another of the witnesses, on similar assumption as to post-war employment, and assuming a national income of $100,000,000,000 to $110,000,000,000, measured by prices prevailing in 1942, estimated $74,000,000 as the probable minimum of such revenues, to be expected in the first post-war year and to be followed by generally increasing revenues thereafter. A third of the witnesses testified in support of a 45-percent increase in post-war national income as compared with the immediate pre-war period. A fourth witness presented and testified in support of an exhibit dealing with national income, namely Senate Document No. 40 of the Seventy-eighth Congress, First Session, entitled "Markets After the War—An Approach to their Analysis." The document

was prepared under the direction of the Bureau of Foreign and Domestic Commerce of the Department of Commerce.[11]

It is clear that the witness who estimated $74,000,000, in speaking of national income was referring to net national income[12] rather than total output of goods and services. Comparing the estimates, it would seem that the witness who estimated $86,400,000 was also using net national income as a base. The results of all this testimony may thus apparently be taken as an estimate of $86,400,000 as the average post-war revenues of the debtor's system based on a net national income of $120,000,000,000, measured by prices prevailing in 1942. As compared with that amount, the preliminary estimate of net national income in 1942, as shown in the exhibit above mentioned was $119,800,000,000. And as compared with the estimate of $86,400,000 for the debtor's system revenues when such a level of net national income is reached, the debtor's system revenues in 1942 were $90,079,600, the greatest up to that time since 1926. None of the witnesses presenting this line of testimony offered any suggestions as to the amounts of post-war operating expenses, post-war taxes, or post-war net income available for fixed charges or interest. As to the debtor's post-war income available for interest and dividends, in relation to net national income, it is no doubt significant that, according to preliminary estimates, while net national income increased 62.0 percent between 1929 and 1943, the sum of interest and dividends, net rents and royalties and undistributed corporate profits declined 1.7 percent on a national basis.

As compared with the $86,400,000 of revenues estimated for the post-war period, system revenues have been as follows:

| | |
|---|---|
| Year 1928 | $ 85,782,818 |
| Year 1929 | 89,109,286 |
| Year 1930 | 74,208,767 |
| Year 1931 | 57,112,998 |
| Year 1932 | 42,672,136 |
| Year 1933 | 40,693,596 |
| Year 1934 | 41,851,794 |
| Year 1935 | 42,425,021 |
| Year 1936 | 50,182,968 |
| Year 1937 | 51,218,937 |
| Year 1938 | 45,107,543 |
| Year 1939 | 47,716,097 |
| Year 1940 | 48,180,971 |

[11] On brief, the debtor asserts that this exhibit indicates post war gross income of $96,000,000 for the debtor, if post-war capacity output of goods and services is realized. However, as stated by the witness, the exhibit is not a forecast.

[12] Net national income is the amount equal to the total output of goods and services less (1) depreciation, depletion, and other business reserves, including charges to current earnings on account of capital outlays and inventory revaluations, and (2) business taxes. While none of the item thus excluded from consideration may have any effect on railway revenues, it is apparent that railway charges for depreciation and taxes will have a decided effect on railway income available for payment of interest and dividends, a factor on which capitalization after reorganization must largely be based.

| | |
|---|---|
| Year 1941 | 61,835,203 |
| Year 1942 | 90,079,600 |
| Year 1943 | 112,961,746 |
| Average | $ 61,321,218 |

In our opinion, to base the new capitalization on the estimates under discussion would be in effect very much the same thing as basing it on the high earnings received during the war period, with too little consideration given to the lower earnings received in other past years. As to that, we adhere to the views stated in other similar cases that an appropriate new capitalization intended to serve for the indefinite future can not safely be determined in such manner.

However, since the time of the earlier hearings and our prior reports, new sources of traffic have been opened up in considerable numbers. Exclusive of war installations, industries were located on the railroad during the period 1939 to 1943, producing an estimated $5,772,053 of annual revenues. War installations have also been added, some of which are expected to be permanent. But the cotrustee, and former president of the company, was firm in the opinion that it was not reasonable to expect that the railroad would continue with as much of gross revenues after the war as during it. He believed that annual revenues were increased on account of the war by at least $25,000,000. The chief traffic officer was of the view that the increase was even greater.

It appears that the property is in good condition, with no deferred maintenance except for a shortage of 67 miles of 112-pound rail, and is well supplied with equipment.

Considering the properties and their condition, the new business mentioned, prospective earnings, the objections of the debtor,[13] and the entire record before us, including the investment account and the reproduction estimates, and with due attention to the unusual amount expended for the upbuilding and maintenance of the road during the time it was in receivership and trusteeship, we are of the opinion that the new capitalization of some $240,000,000 heretofore approved by us should be increased, and that the total new capitalization proposed by the bondholders' committees, approximately $247,838,808, should be approved. Since this amount, increased by the maximum sum of cash that might be distributed, is less than the claims of mortgage creditors, $366,030,385, the equities of the preferred and common stockholders and the claims of general creditors and creditors, other than mortgage creditors having priority over general creditors but not over mortgage creditors on any part of the property, are found to be without value.

Also from the entire record, and mindful that the debtor has for reasons above indicated urged a maximum of interest-bearing securities, we further find that the amounts of the several classes of new bonds and stocks comprising the capitalization proposed by the bondholders, are well proportioned, and adapted to the requirements of a necessarily variable income. Fixed-interest charges are thus $3,001,-

[13] The contention of the debtor, on brief that reorganizations under section 77 in which no provision is made for participation by holders of outstanding stock, are injurious to railroad credit, has also been considered.

773, and contingent charges, including interest and sinking-fund payments $2,560,954. For full dividends on the preferred stock an additional $3,092,989 annually will be sufficient. The amounts of the several classes of new bonds and stocks comprising the capitalization proposed by the bondholders are accordingly approved.

*Distribution of new securities and cash.*—The debtor, as stated, contends that before a plan is put in final form a settlement of the bank claims should be negotiated so that the collateral held for the claims may be released. Apparently, a settlement for less than the amount owing on the claims and less than the value of the collateral is suggested. The amount owing on the bank claims as of January 1, 1944, was $7,397,788; and the total of new securities and cash allocated to such claims under the bondholders' plan is $6,891,747. There is nothing in this, or otherwise in the record, to indicate that a settlement such as the debtor suggests could be arranged.

The debtor contends further, on brief, that in computing the benefits awarded the holders of prior-lien bonds as an offset to their change of position, the saving of income taxes should be scheduled. It states that these bondholders, by foregoing, as alleged, the distribution of $13,000,000 in interest earned during operation by the trustees, have apparently avoided the payment of income taxes on that amount. Since the income taxes of the trust estate were not affected by the withholdings of earnings from the payment of interest, it is assumed that the contention has reference to additional income taxes which the bondholders would have been required to pay if they had received additional distribution of interest. No merit is found in this contention.

For the distribution of new securities, the bondholders' committees propose a method of comprising three steps. First, the securities were initially distributed among outstanding claims and the retired claims of the Birmingham bondholders, the Reconstruction Finance Corporation, and the Railroad Credit Corporation, as though the retired claims mentioned were outstanding. This step was based on an allocation of 47.55 percent [14] of net earnings to liens on the property of the Fort Scott district and 52.45 percent [14] to liens on the property of the prior-lien district, and is the same in principle as the distribution approved in our prior reports, except that in the present proposals the retired claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation were not considered as having had when outstanding any special equities additional to their rights in pledged collateral securities.

After such distribution, and as the second step in the computations, the securities initially allocated to the retired claims were redistributed to outstanding claims, on a basis intended to produce results equivalent to subrogation in the proportions that funds for the payments in respect of the retired claims were supplied from earnings withheld from the payment of interest. Of the total of such funds, holders of liens on the property of the prior-lien district were considered as supplying 52.45 percent, and holders of liens on the property of the Fort Scott district as supplying 47.55 percent. The funds supplied by the Fort Scott district were considered at this point as having all

[14] These ratios are explained in our prior reports.

been applied to the retirement of the Birmingham bonds; and the funds supplied by the prior-lien district as having been applied in part to the retirement of the Birmingham bonds and in the remaining part to the settlement of the claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation.

The third step was the adjusting of the results obtained from the first two steps, apparently as a matter of practical compromise rather than strict adherence to the subrogation theory. However, the primary assumption that funds for the retirement of the claims mentioned were supplied by holders of liens on the properties of the Fort Scott and prior-lien districts, in the proportions of 47.55 percent and 52.45 percent, respectively, appears to do somewhat less than justice to the latter. These ratios were arrived at from a study of the earnings of 1934, 1936, and 1937, when earnings were low as compared with 1940 through 1943. At the higher levels of earnings the proportion of the total allocable to the prior-lien district increases. And moreover, the theory of subrogation, in application, does not reach the benefits to the entire estate arising from a more expeditious reorganization. We have examined the results as well as the methods of the committee's proposed allocation of new securities, and are of the view that despite minor inconsistencies of theory as mentioned, the results give due recognition to subrogative rights and are in all respects fair and equitable, subject to an examination of the question of compensation for sacrifices of position and loss of senior rights.

No question of compensation arises as to the treatment of the prior-lien bonds in relation to junior interests, since no junior interest is recognized in the plan. Similarly no question of compensation arises as to the treatment of the consolidated bonds. These considerations do not, however, apply to the Fort Scott bonds, and the question of compensation for their change of position must, therefore, be considered. The sacrifices of position which the plan requires of the Fort Scott bonds are the extension of their maturity the reduction of 26.7 percent of their claim to an income-bond position, and the admission of junior claims to recognition in the same security, income bonds, in which a part of the Fort Scott claim is satisfied. In return for these sacrifices, however, the Fort Scott bonds will receive compensation in several ways.

Some 73.3 percent of the claim of Fort Scott bonds will be exchangeable for new first-mortgage bonds, the interest on which will be earned at lower levels of system income than would be the interest on the present Fort Scott bonds. The other 26.7 percent of claim will be exchangeable for second-mortgage bonds, on which the interest will be contingent but partly cumulative and at the increased coupon rate of 4½ percent in lieu of the 4-percent rate borne by the Fort Scott bonds; and conversion rights are added which should prove of substantial value if future earnings are sufficient to pay adequate dividends on the new common stock. Sinking funds for both the new first-mortgage bonds and the second-mortgage bonds are provided, where none is now provided for the Fort Scott bonds. In our view the Fort Scott bonds will receive full compensation for their sacrifices of position and loss of senior rights. The proposed distribution of new securities is accordingly approved.

The committee's proposed distribution of cash in reorganization is in harmony with their proposed distribution of new securities. The first step in the computation of the amount to be distributed was to allocate to prior-lien 5- and 6-percent bonds, including bonds previously pledged with the Reconstruction Finance Corporation and bonds pledged under the consolidated mortgage, a sum sufficient to make up for the amount by which payments thereon under the court's orders of 1940, 1941, and 1942 were less than 125 and 150 percent, respectively, of the amounts paid on the 4-percent prior-lien bonds.[15] Correspondingly, a sum, in the proportion of 47.55 percent to 52.45 percent, of the total required for the purpose last mentioned, was allocated to Fort Scott bonds outstanding and pledged. And the sums thus allocated to Fort Scott and prior-lien bonds pledged under the consolidated mortgage were reallocated to consolidated-mortgage bonds outstanding and pledged, including those previously pledged with the Reconstruction Finance Corporation.

In the latter operation there was first allocated to consolidated-mortgage 6-percent bonds a sum sufficient to make up for the amounts by which payments thereon under the court's orders mentioned were less than 133.33 per cent of the amounts paid on 4½-percent consolidated-mortgage bonds;[15] and then the remainder was allocated to all outstanding and pledged consolidated-mortgage bonds, including those previously pledged with the Reconstruction Finance Corporation, in proportion to the interest rates carried.

The second step was to reallocate the sum initially allocated to the bonds previously pledged with the Reconstruction Finance Corporation. This sum was distributed among prior-lien bonds outstanding and those pledged under the consolidated mortgage in proportion to the interest rates carried. And the sum thus allocated to prior-lien bonds pledged under the consolidated mortgage was then reallocated to consolidated-mortgage bonds outstanding and pledged, not including those previously pledged with the Reconstruction Finance Corporation, in proportion to the interest rates carried.

The third step was to allocate by similar methods the Reconstruction Finance Corporation share in 1943 interest distributions on prior-lien and consolidated-mortgage bonds,[16] to prior-lien bonds outstanding and pledged, not including those previously pledged with the Reconstruction Finance Corporation, in proportion to the interest rates carried; and then reallocate the sums thus distributed to prior-lien bonds pledged under the consolidated mortgage, to consolidated-mortgage bonds in proportion to interest rates carried.

The fourth and last step was to allocate a further sum sufficient to bring total interest payments on Fort Scott bonds current to January 1, 1944, and at the same time increase payments on prior-lien bonds outstanding and pledged, including those previously pledged

[15] Interest paid prior to 1940 was on the basis of coupon rates, and that paid in 1940, 1941, and 1942 on the basis of new securities proposed to be issued under the plan heretofore approved. The adjustment here made reverses the effect of previously adopting, in the apportionment of interest payments, the date January 1, 1940, as the effective date for the issue of new securities.

[16] The amounts payable, at the specified rates, in respect of bonds then pledged with the Reconstruction Finance Corporation and held by the trustee for the account of those entitled.

with the Reconstruction Finance Corporation, to the extent required to preserve the proportions of 47.55 and 52.45 percent as between allocations to the Fort Scott district, on the one hand, and the prior-lien district, on the other, allocations to prior-lien bonds being in proportion to the interest rates carried. The amounts thus allocated to Fort Scott and prior-lien bonds pledged under the consolidated mortgage were reallocated to consolidated-mortgage bonds outstanding and pledged in proportion to the interest rates carried; and the amounts allocated to bonds previously pledged with the Reconstruction Finance Corporation were reallocated by the same methods followed in the second step above referred to. The results are as indicated in the plan. Total requirements for these distributions would be $6,585,822, as compared with $20,336,617 of cash on hand on December 31, 1943.

By similar methods of computation, the provisions made for apportionment of any additional cash that may be distributed prior to consummation of the plan, and for adjustment, under the circumstances mentioned in the plan, of the allocation of income bonds, were arrived at. The adopted ratio as between districts was consistently followed out. And in both cases the bonds previously pledged with the Reconstruction Finance Corporation were treated as outstanding and sharing in the allocations in the first instance, so as to preserve the subrogative rights therein of these entitled thereto until such rights shall be finally merged in the rights evidenced by the new securities to be distributed in consummation of the plan. The subrogative rights arising from the retirement of the Birmingham bonds are preserved and reflected in the distribution to Fort Scott bonds outstanding and pledged of the entire share of the Fort Scott district in system earnings, without deduction in respect of Birmingham bonds retired. There is apparently a minor inconsistency here in favor of the Fort Scott bonds, offset, however, in the allocation of new securities.

The committees' proposals for distribution of cash in reorganization for any distribution of cash prior to reorganization, and for adjustment, under circumstances mentioned in the plan, of the allocation of new income bonds appear fair and equitable and are accordingly approved; except that, to meet the objections of the debtor, it will be expressly provided that distributions of cash before the consummation date shall be credited against claims. Such credit would at all event be a necessary incident of any such distribution.

*Consummation date.*—The court in its opinion of July 25, 1942, suggested consideration of an effective date later than January 1, 1940, the date previously approved by us. The committees propose that the date for giving effect to the plan shall be left for determination of the court by subsequent order on application of the reorganization managers. The debtor interprets this proposal of the committees as a suggestion for deferred consummation of the plan; and urges that if we approve deferment of the consummation date, allocation of the new securities should be deferred, until a few years after the end of the war. We do not so construe the proposal; and see no reason why, if approved, it should result in any delay in consummation of the plan. The proposed provision does not contemplate any increase in the permissible capitalization nor any substantial deviation from the basic

method of allotment of securities herein approved. The proposal should facilitate consummation and is accordingly approved.

*First-mortgage bonds.*—The provisions of the bondholders' plan relative to a sinking fund for the new first-mortgage bonds of series A, specify that all first-mortgage bonds or other obligations acquired by any sinking fund shall be forthwith canceled. In our opinion, bonds or other obligations acquired for the sinking fund for series A first-mortgage bonds should be held in the sinking fund and continue to draw interest so long as any series A bonds are outstanding.

The proposed provision of the new first mortgage for modification of its terms, upon concurrent action of the reorganized company and of the holders of not less than three-fourths in aggregate principal amount of the bonds affected, so as to postpone the time of payment of principal or interest, is made applicable to series of bonds other than series A only in the event that it shall be so prescribed in the mortgage or in a supplemental indenture. In our opinion, the same provision as has been made for series A should be made for other series, in this respect, since the controlling considerations appear the same as respects all series.

*Second-mortgage bonds.*—The provisions of the bondholders' plan relative to a sinking fund for the new second-mortgage bonds of series A, specify that all bonds of series A purchased or redeemed by operation of the sinking fund shall be held in the sinking fund so long as any series A bonds are outstanding. In our opinion, bonds so purchased or redeemed should be forthwith canceled, and no bonds or other obligations should be issued in lieu thereof.

The proposed second mortgage provides that the reorganized company, in any supplemental indenture creating a new series of bonds, may surrender the privilege to make certain modifications or alterations of its terms. In our view, the provision for such surrender should be eliminated, as financially inadvisable.

*Ascertainment and disposition of available net income; special reserve fund.*—Provision is made in the bondholders' plan that in the ascertainment of net income applicable to payment of contingent interest, no amounts shall be charged to operating expenses for retirements of nondepreciable property. It will be seen that an enforced impairment of capitalization, and perhaps of the security for the new first-mortgage bonds, will result from such provision if, as they may be, payments of contingent interest are increased over the amounts that can be paid from income and surplus. Such result, if it takes place, may be expected, however, to be offset in part at least by subsequent appropriations of income for sinking-fund payments and other capital purposes. We are of the opinion that the provision in question may be approved in this case.

In lieu of a capital fund or capital expenditures fund, the bondholders' plan provides for a special reserve fund. The latter, unlike the usual capital funds which we have approved in other cases where contingent-interest securities were included in the new capitalization, is not a fund which, with or without a payment from available income, will operate to reserve sums equal to or based on charges for depreciation and retirements of property, for subsequent use in debt reduction, or for other specified capital purposes; but a fund, replenished from time to time from available net income, which is intended to provide

cash, when not available from other sources, for payment of fixed charges or for capital expenditures. In view of recent changes in our accounting regulations requiring depreciation accounting for roadway accounts, and the evidence of record, we are of the view that the special reserve fund may be approved in this case, in lieu of a capital fund or capital reserve fund.

The debtor objects to the provisions of the bondholders' plan last mentioned on the ground that no necessity for such a fund is shown in the record. The debtor's record of earnings, in our view, shows good reason for the proposed reserve fund. The objection is not sustained.

For clarity, editorial changes from the provisions of the bondholders' plan, should be made in the approved plan, in the last sentence of subparagraph (3) relating to application of available net income. It is believed that no change in the meaning will result.[17] As thus modified the provisions are approved.

*Claims not affected by the plan.*—Under this heading in the approved plan there has been added a paragraph, not found in the bondholders' plan, relative to settlement of transportation accounts with the United States. We find that the added provisions are fair and equitable and may be expected to facilitate the carrying out of the plan. They are approved. We find that the claims mentioned in this paragraph of the plan will not be materially and adversely affected by the plan.

The bondholders' plan provides that the expenses of reorganization as allowed by the court, subject to the provisions of section 77 of the Bankruptcy Act, shall be paid in cash or assumed by the reorganized company as a cost of administration prior in lien to the new securities issued under the plan. In our view, and in order to conform to plans heretofore approved by us in other cases, it should be provided that such expenses shall be paid in cash. (See also *In Re New Housing Corporation*, 117 Fed. (2d) 569, 571.) The approved plan will so provide. We find accordingly that the interests of the holders of claims for such expenses of reorganization will not be adversely and materially affected by the plan.

The provisions of the bondholders' plan for the 100 shares of outstanding Fort Scott preferred stock appear to be in conformity with the ruling made with reference to that stock in the court's opinion of July 25, 1942; and are accordingly approved. We find that the claim with respect to such stock will not be materially and adversely affected by the plan.

*Reorganization managers, board of directors, and voting trust.*—In its opinion of July 25, 1942, the court suggested that we give further attention to the matter of the setting forth in the new plan of appropriate machinery with reference to the reorganization managers and the naming of the first board of directors, and if necessary, provisions for a voting trust. The bondholders propose that a voting trust shall be created in order to assure a stable, experienced, and impartial management during the transition period which will follow the consummation of reorganization and the termination of the war. Under this proposal, the voting trustees would be three in number, one to be designated by the prior-lien bondholders' committee, and one by the

17 A few editorial changes should also be made elsewhere in the plan.

consolidated-mortgage bondholders' committee, both subject to the approval of the court, and one to be designated by the court; and the trust would continue for 10 years from the consummation date of the plan. The bondholders further propose that the members of the first board of directors shall be designated by the reorganization managers with the approval of the court; and that there shall be four reorganization managers, of whom one shall be designated by each of the three bondholders' committees, all subject to the approval of the court, and one by the court.

In our opinion, such provisions should be modified so that (1) if the court shall find that at the time of designation of reorganization managers or of voting trustees any of the committees no longer holds or represents a substantial interest in the property, the court may, in its discretion, designate in lieu of such committee, and (2) the term of the voting trust shall be limited to 5 years. As thus modified, the provisions in question are approved.

*Execution of the plan by sales.*—The debtor objects to the provisions of the bondholders' plan for its execution if so ordered by the court, by a sale or sales, at not less than fair upset prices to be fixed by the court, of all or any part of the property of the debtor. The grounds stated for the objection are that the provision is an attempt to add forfeiture to expropriation through sales made in violation of the rules of the bankruptcy courts, and in disregard of the statutes governing sales of mortgaged property of the various States in which the debtor's property is located, and contemplates chilled bidding and the appropriation of a part of the debtor's own assets for the payment of the purchase price at any sale held under the plan. The provisions assailed do not in our view attempt any of these things, appear reasonable, and are approved.

*Debtor's request for findings.*—The debtor requests findings as set out in the footnote. Responses which we consider appropriate also are shown in the footnote.[18]

*Conclusions.*—We conclude, upon further consideration, (1) that the plan of reorganization approved by order entered on July 6, 1940, and modified by order entered on November 16, 1940, should be further modified so as to conform with the plan set forth in the order entered herewith, which is the same as the bondholders' plan submitted February 16, 1944, except for the differences above indicated in this report; and (2) that as thus modified the plan will meet the

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[18] 1. A finding stating the total amount of creditors' claims in dollars for which new securities are alloted in reorganization.

The amount is $356,457,561, after deduction for proposed distributions of cash.

2. A finding stating the total book cost of debtor's assets, less current liabilities and adjusted credits, found and used by the Commission as a factor in determining the value of the debtor's assets.

The book cost of the debtor's total assets less current liabilities and unadjusted credits is $397,015,888.73. See No. 3 below.

3. A finding stating the weight given such factor in a final determination of capitalization of debtor's assets.

None. The sum includes noncapitalizable assets.

4. A finding stating the reproduction cost less accrued depreciation of the debtor's road, structures and equipment, as of January 1, 1940, brought down to January 1,

requirements of subsections (b) and (c) of section 77 of the Bankruptcy Act, as amended, will be compatible with the public interest, and should be approved.

An appropriate amendatory order will be entered.

COMMISSIONER MILLER did not participate in the disposition of this case.

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1944, by appropriate additions and deductions of additions to capital assets and retirement of property and equipment depreciation set up since January 1, 1940.

Not found. See above in this report.

5. A finding stating the applicable period used for prices of material and labor in finding cost of reproduction new.

See above in this report as to estimate as of December 31, 1936.

6. A finding stating the amount of accrued depreciation of road and structures deducted, if any, in finding cost of reproduction new.

None.

7. A finding stating what, if any, going-concern value is included in the finding of cost of reproduction new.

None.

8. A finding stating the weight given the final cost of reproduction new less depreciation of road structures, and equipment in determining capitalizable value of the debtor's assets.

Not possible to state, since the Commissioners approving this report have not necessarily arrived at their agreed conclusions after assigning the same weight to each component part of all the relevant evidence.

9. A finding stating what future earning power the Commission may use in arriving at the capitalizable value of debtor's assets.

See above in this report.

10. A finding stating what weight such future earning power is given by the Commission in determining the capitalizable value of the debtor's assets.

See above in this report, and also response to request for finding No. 8.

11. A finding stating to what extent, if any, debtor's road and structures are undermaintained.

See above in this report.

## APPENDIX A

*Present capital structure and distribution of new securities under the further modified plan*

| Obligations [1] | Principal amount | | Interest to Dec. 31, 1943 not previously authorized to be paid | Total claims as of Jan. 1, 1944 | Cash payment to be applied to interest | Balance of claims | Undisturbed | First-mortgage, 4-percent bonds maturing 50 years from date series A | Second-mortgage, 4½-percent income bonds maturing 75 years from date series A [2] | Preferred stock 5 percent series A [3] | Common stock no par value shown at $50 a share | Total capitalization |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jan. 1, 1940 | Jan. 1, 1944 | | | | | | | | | | |
| Equipment obligations | $5,874,000 | $2,986,000 | | $2,986,000 | | $2,986,000 | $2,986,000 | | | | | $2,986,000 |
| Fort Scott 4's of 1936 | 25,835,000 | 25,835,000 | $1,584,719 | 27,419,719 | $1,584,719 | 25,835,000 | | $18,937,055 | $6,897,945 | | | 25,835,000 |
| Prior lien 4's of 1950 | 91,887,097 | 91,887,097 | 33,001,234 | 124,888,331 | 1,411,391 | 123,476,940 | | 20,123,274 | 15,712,694 | $30,506,516 | $30,644,347 | 96,986,831 |
| Prior lien 5's of 1950 | 25,561,500 | 25,561,500 | 11,634,061 | 37,195,561 | 649,008 | 36,546,553 | | 5,955,830 | 4,652,193 | 9,023,210 | 9,074,332 | 28,705,565 |
| Consolidated 4½'s of 1978 | 108,305,000 | 108,305,000 | 42,387,284 | 150,692,284 | 2,279,835 | 148,412,449 | | 23,935,405 | 17,112,190 | 18,845,070 | 18,845,070 | 78,737,735 |
| Consolidated 6's of 1936 | 10,000,000 | 10,000,000 | 5,449,700 | 15,449,700 | 302,200 | 15,087,500 | | 2,430,000 | 1,740,000 | 1,910,000 | 1,915,000 | 7,995,000 |
| Bank loans 6 percent of 1932: | | | | | | | | | | | | |
| Chase | 2,492,592 | 2,492,592 | 1,042,386 | 3,534,978 | 151,526 | 3,383,452 | | 1,016,590 | 727,929 | — 799,049 | 801,140 | 3,344,708 |
| Guaranty | 1,042,894 | 1,042,894 | 489,942 | 1,532,836 | 56,594 | 1,476,242 | | 379,688 | 271,875 | 298,437 | 299,219 | 1,249,219 |
| Central Hanover | 433,469 | 433,469 | 196,655 | 630,124 | 22,638 | 607,486 | | 151,875 | 108,750 | 119,375 | 119,688 | 499,688 |
| Bankers Trust | 422,811 | 422,811 | 199,765 | 622,576 | 22,637 | 599,939 | | 151,875 | 108,750 | 119,375 | 119,688 | 499,688 |
| Mercantile Commerce | 402,113 | 402,113 | 185,897 | 588,010 | 22,637 | 565,373 | | 151,875 | 108,750 | 119,375 | 119,687 | 499,687 |
| First National of St. Louis | 342,984 | 342,984 | 146,280 | 489,264 | 22,637 | 466,627 | | 151,875 | 108,750 | 119,375 | 119,687 | 499,687 |
| | 272,599,460 | 269,711,460 | 96,317,923 | 366,029,383 | 6,585,822 | 359,443,561 | 2,986,000 | 73,385,342 | 47,549,826 | 61,859,782 | 62,057,858 | 247,838,808 |

[1] The debtor's capital stock consists of $49,158,300 of preferred and $65,543,226 of common. The equities of the holders of these stocks have been found to be of no value. The interests of creditors not having priority over one or more of the mortgages found to be of no value.

[2] Until called for redemption, convertible at the option of the holders into common stock at any time within 5 years after date, at the rate of 30 shares for each $1,000 bond, and thereafter at the rate of 25 shares. Interest is cumulative up to 18 percent.

[3] Holders will be entitled, in preference to the holders of the common stock, to receive dividends, when and as declared by the board of directors, at the rate of 5 percent per annum out of the available net income for any calendar year. The dividends will be cumulative to the extent that available net income is applicable (or would have been applicable except for appropriations for capital expenditures) but is not distributed.

## APPENDIX B

*Summary of modified plan*

| | Principal amount | Annual charges |
|---|---|---|
| **Fixed interest debt:** | | |
| Equipment obligations | $2,986,000 | $66,359 |
| New first-mortgage bonds, series A | 73,385,342 | 2,935,414 |
| Total fixed interest debt | 76,371,342 | 3,001,773 |
| **Other obligations:** | | |
| Capital expenditures, appropriation discretionary | | 183,463 |
| Sinking fund for first-mortgage bonds, series A | 47,549,826 | 2,139,742 |
| Second mortgage bonds series A | | 237,749 |
| Sinking fund for second-mortgage bonds, series A | | |
| Total debt | 123,921,168 | 5,562,727 |
| Total charges ahead of dividends | 61,859,782 | 3,092,989 |
| New 5 percent preferred stock | 62,057,858 | |
| New no-par common stock at $50 a share | | |
| Total capitalization | 247,838,808 | |

# INTERSTATE COMMERCE COMMISSION

## FINANCE DOCKET NO. 10008

## ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY REORGANIZATION

*Submitted September 11, 1944. Decided October 2, 1944*

Petition for further modification of modified plan of reorganization for the St. Louis-San Francisco Railway Company approved July 4, 1944, pursuant to the provisions of section 77 of the Bankruptcy Act, as amended, denied.[1]

Appearances as in prior report and also *Jesse E. Waid* for mortgage trustee.

### SECOND SUPPEMENTAL REPORT OF THE COMMISSION

BY THE COMMISSION:

Within the statutory period of 60 days from the date of our amendatory order of July 4, 1944, 257 I. C. C. 399, further modifying and approving a plan of reorganization for the St. Louis-San Francisco Railway Company, debtor, pursuant to the act of July 1, 1898, entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States," as amended, a petition for its modification was filed by the debtor, and a memorandum by the bondholders' committees and mortgage trustees. No replies have been filed.

By the terms of section 77 (d) of the act, we may after rendering a report and order in which we have approved a plan of reorganization, upon petition for good cause shown, filed within 60 days of the date of our order, and upon further hearing if we shall deem necessary, modify in a supplemental report and order any plan which we have approved, stating the reasons for such modifications. No further hearing or oral argument is deemed necessary. In this report we shall confine our discussion generally to those matters which the petition indicates were insufficiently discussed in our prior report.

The debtor in its petition charges us with error in 21 particulars. In a supporting brief filed under the same cover with the petition, the debtor cites authorities in an effort to show that its constitutional rights have been violated, and cites further authorities in an effort to show that other established rules of law are violated. It argues that it is entitled to a substantial interest in the reorganized corporation.

*Interest during administration and effective date of the plan.*—The debtor in its petition charges *inter alia* that our plan and order err (*a*)[2] in failing to fix the effective date of the plan, (*b*) in providing for an allocation of securities without fixing an effective date, (*c*) in permitting the various classes of secured creditors to receive securities on

[1] For previous reports see 257 I. C. C. 399.

[2] The designating letters are the same as those used in the petition in enumerating the particular contentions.

the basis of claims increased since May 16, 1933, by varying contract interest rates, (*d*) in failing to differentiate between the amounts which secured creditors are entitled to receive out of the earnings realized by the trustees' operations, and the right, if any, to accrue unearned interest during the administration of the property by the trustees, (*e*) in failing to give weight and effect to equitable considerations well recognized under the law of the land to any claim for such accrued but unearned interest, and (*f*) in failing to permit the court to make use of its equitable powers and relieve the debtor of such claims for accrued but unearned interest by fixing an effective date of the plan at which the interest obligations of new securities become effective. It also charges that we erred (*h*) in our response to its request for finding No. 1 because, as alleged, the total of claims as stated is excessive by the amount of accrued and unearned interest computed at unequal rates, and because the amount is not now determinable without the fixing of an effective date of the plan.

On brief the debtor argues that under the scheme of section 77 and under the decisions in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, and *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523, it is within the power of this Commission so to adjust the effective date of the plan that there will not be a large accumulation of unearned interest during administration. In both of those cases it was argued that the effective date of the plan must be the date of the filing of the petition, but decided otherwise in each instance. In the *Western Pacific* case no contention was made that fully secured claims do not bear interest to the date of reorganization, whatever it may be. It was there argued that subsection (1) fixes the date of the filing of the petition as the date of the plan, but held that the provisions of subsection (b) empower this Commission to select the date for institution of reorganization. In the *Milwaukee* case the contention was made on the theory that section 77 does not permit the accrual of interest after the date of the filing of the petition, but it was held that interest on secured claims accrued to the effective date of the plan was entitled to the same priority as the principal. It will be seen that while the rule as to interest to the effective date is laid down,[3] neither of the opinions cited affords a method for determining the proper effective date of the plan. This question is discussed at length in our report in *Chicago, M., St. P. & P. R. Co. Reorganization*, 254 I. C. C. 707, 721.

In our opinion the debtor's allegations of error (*a*) to (*f*), inclusive, are without merit.

As to allegation (*h*) it will be seen by reference to the appendixes of the proper report that the sum of $356,457,561 represents the total of secured creditors' claims included in capital structure as of January 1, 1944, less (1) equipment obligations and (2) cash payments proposed to be applied to interest. The debtor contends *inter alia* that we erred in making the finding because, as alleged, the amount is not determinable without fixing an effective date of the plan. The total of secured creditors' claims will increase as additional interest is accrued and

[3] *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, is fully complied with in this reorganization. Secured creditors are looking only to their liens. There are no free assets.

will diminish as payments, if any, are made. It is true, therefore, that such total cannot be precisely ascertained for an undetermined future date. However, the finding is accurate and unambiguous as a statement of conditions as of January 1, 1944. That is all that was possible when the finding was made, and, therefore, that is all that the debtor's request reasonably construed, may be understood to have called for.

*Capitalizable assets.*—The debtor objects to our response to its request for a finding of the weight given the book cost of total assets less current liabilities and unadjusted credits, in the final determination of new capitalization. We stated that no weight was given, explaining that the sum included noncapitalizable assets. The debtor contends *inter alia* that the explanation tendered is not supported by evidence. Evidence that noncapitalizable assets were included in the sum in question is contained in the balance sheet and other exhibits of record. (See *Louisville & N. R. Co. Securities*, 76 I. C. C. 718.)

*Reproduction cost.*—The debtor charges error in our response to its request for a finding of the applicable period used for prices of materials and labor in finding cost of reproduction new. It asserts *inter alia* that the estimate of December 31, 1936, referred to in the response is not supported by a fact or facts proved by competent evidence. The estimate of December 31, 1936, in question is contained in a report of our Bureau of Valuation filed in the proceeding in 1938 by direction of division 4 of this Commission, under the provisions of section 77 (e) (11) of the Bankruptcy Act. The report, by the terms of the section, is prima facie evidence of the facts therein stated, including reproduction cost as of December 31, 1936. Later testimony on the subject of reproduction cost, presented by the debtor before the special master, dealt with reproduction cost as of December 31, 1940, and rebutted only in part the estimate as of December 31, 1936. The consideration we gave to the reproduction estimates is indicated in our report of July 4, 1944.

*Earning power.*—The debtor argues on brief that we have violated its constitutional rights and violated other established rules of law in not basing new capitalization on balance sheet assets, or on an estimate of reproduction cost, to the exclusion of evidence of its impaired earning power. Despite numerous references to authorities, which are controlling only where aptly cited, and which we find it unnecessary to discuss at length, we hold that the debtor's views on this question are untenable in the light of the express provisions of the section 77 (e) and of *Ecker* v. *Western Pacific R. Corp.*, *supra*, and *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, *supra*.[4]

*Execution of plan by sales.*—The debtor is critical of the provisions of the plan for its execution by sales, if so ordered by the court, on the ground that the court does not have sufficient jurisdiction to direct and supervise such sales in the manner proposed. This is a question for the court, and not for this Commission. However, the plan expressly provides that the court may cure any defect of this character.

[4] Debtor argues that all estimates of earning power are unreliable, and earning power in the case of regulated railroads more so than unregulated enterprises. No circumstances peculiar to the debtor are mentioned in this connection. The opinions we have cited deal with railroads.

*Conclusions.*—We conclude that the petition of the debtor for modification of the plan of reorganization should be denied.

An appropriate supplement order will be entered.

COMMISSIONERS PORTER and MILLER did not participate in the disposition of this proceeding.

IN THE

# DISTRICT COURT OF THE UNITED STATES

FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI

| | |
|---|---|
| In the Matter of the Reorganization of ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, *Debtor.* | In Proceedings for the Reorganization of a Railroad. No. 7004. |

## OPINION OF THE COURT

A plan of reorganization for the St. Louis-San Francisco Railway Company has been before this Court before and was disapproved and returned to the Interstate Commerce Commission for further consideration. *In re St. Louis-San Francisco Ry. Co.*, 46 F. Supp. 120. The Interstate Commerce Commission has now forwarded a new plan embodied in its "Report of the Commission on Further Consideration," under date of July 4th, 1944 and "Second Supplemental Report," under date of October 2nd, 1944, which reports were filed on July 15th and October 7th, 1944, respectively.

The full details of the present Commission plan are of record and will not be here repeated. It is sufficient to say that this new plan does not radically differ from the original plan ruled on by this Court in 1942, although it has various altered aspects, most of which will subsequently appear in the course of this opinion.

Since and after this Court's prior opinion and order of disapproval in July of 1942, an appeal was taken by the Reconstruction Finance Corporation and the Railroad Credit Corporation, but pending the preparation of said appeal, due to the increased earnings from operations, it became possible to pay off the Birmingham bonds and to settle the claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation. Such acts were deemed desirable in the interest of the public and the bondholders, since it eliminated delay in reorganization, and the settlement was negotiated, approved by this Court, and the case remanded to the Commission for further hearings, in accordance with this Court's opinion.

In the meantime, the three bondholder committees had negotiated amongst themselves a new plan which they found mutually satisfactory and responsive to changes in conditions since the Commission's 1940 decision, and, the cooperation of the three indenture trustees having been obtained, this negotiated bondholders' plan was proposed to the Commission, at a hearing in February of 1944. In its Report now here for consideration, the Commission has approved a plan which, although not identical with the above mentioned negotiated bondholders' plan, was also acceptable to said bondholders and is substantially the same. Subsequently, in its "Second Supplemental Report," the Commission,

on October 2nd, 1944, overruled in entirety objections that the Debtor had filed to its plan, and the plan, together with a transcript of the proceedings, was thereupon certified here according to law. On October 11th, 1944, the Court entered its order requiring all objections and claims for equitable treatment to be filed by November 6th, 1944, and notice having been given, objections were filed only by the Debtor corporation and by Lola Brooks, Administratrix of the Estate of F. S. Brooks, Deceased, and John E. Dikis, Administrator of the Estates of the Decedents Leonard C. Lee, Homer C. Lee and Robert E. Lee. On the other hand, the present plan is supported by the joint action of the following interested parties:

(1) The Fort Scott Committee, which consists of persons either representing, or officers of corporations owning, substantial amounts of Fort Scott bonds and which held deposits and assents in the aggregate principal amount of $9,496,000 on November 1, 1944;

(2) The Prior Lien Committee, consisting of persons who are or were officers of corporations owning substantial amounts of Prior Lien bonds and which, on November 1, 1944, held deposits and assents in the aggregate principal amount of $41,054,750.00;

(3) The Consolidated Committee, which consists of persons either representing, or officers of corporations owning or representing, substantial amounts of Consolidated bonds and which held deposits and assents on November 1, 1944, in the aggregate principal amount of $35,620,500.00;

(4) Bankers Trust Company, successor corporate trustee under the refunding mortgage of the Kansas City, Ft. Scott & Memphis Railway Company, dated August 23, 1941, securing the Ft. Scott bonds;

(5) Central Hanover Bank and Trust Company, corporate trustee under the prior lien mortgage dated July 1, 1916, securing the Prior Lien bonds; and

(6) The Chase National Bank of New York City and John A. Aid, Trustees under the consolidated mortgage dated March 1, 1928, securing the Consolidated Bonds.

All of these six interests have filed a joint brief and they represent all issues of bonds now outstanding. There are no other classes of secured creditors and the claims of unsecured creditors and stockholders have been held by the Commission to be without value. Therefore, all creditors whom the Plan recognizes now supported it and, after the long pendency of a reorganization which began in 1933 this Court at long last is presented with a plan which is unopposed save by those whose equity has been extinguished.

A District Court in considering a plan of corporate reorganization has a primary duty under the law, aside from any questions of objections and claims for equitable treatment, to independently satisfy itself of certain fundamentals concerning that plan. It must, in the words of the Act, determine whether—

"(1) it complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders;

(2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge;

(3) provides for the payment of all costs of administration and all other allowances made or to be made by the Judge. * * *" Title 11, U. S. Code, Sec. 205 (e).

Since in this proceeding these features for the most part are not disputed by any persons, the Court will first address itself as briefly as possible to the discharge of this duty.

In determining these questions the Court is naturally influenced in favor of the fair and equitable nature of this plan amongst those recognized by it, by the fact that all of those creditors' representatives now support it, and by the further fact that generally this plan has not been, except in certain respects previously disapproved by this Court, substantially changed from the plan previously presented to this Court and, in 1942, generally approved. The Court feels, however, that to comply with the terms of the Act, it must briefly set forth the salient features of the Plan and state its opinion thereon.

The new capitalization and charges now presented by the Commission, in comparison to those previously considered in the opinion of 1942, are shown by the following tables set out in the Commission's Report:

CAPITALIZATION

| | *Plan Considered in Opinion of 1942* | *Plan Now Before the Court* |
|---|---|---|
| Fixed-interest debt | $ 75,685,319 | $ 76,371,342 |
| Contingent-interest debt | 40,385,885 | 47,549,826 |
| Preferred stock | 61,846,169 | 61,859,782 |
| Common stock | 62,082,631 | 62,057,858 |
| Total | $240,000,004 | $247,838,808 |

ANNUAL CHARGES

| | *Plan Considered in Opinion of 1942* | *Plan Now Before the Court* |
|---|---|---|
| Fixed Charges | | |
| Interest | $ 3,000,117 | $ 3,001,773 |
| Sinking Funds | 32,531 | None |
| Contingent Charges | | |
| Interest | 1,817,365 | 2,139,742 |
| Sinking funds, continuously operative | 401,929 | 421,212 |
| Excess bond sinking fund | Variable* | None |
| Capital bond | 1,125,000 | Variable** |
| Preferred stock dividend | 3,092,309 | 3,092,989 |

* Operative under prescribed conditions only; payment 50 percent of available net income after prior charges.

** Balance of $500,000 required in fund before payment of dividends on common stock.

Under the present plan, holders of outstanding bonds of the several classes will receive respectively for each $1,000 principal amount new securities approximately in the amount specified in the following table, derived from the same source:

| | *First Mortgage 4's* | *Income 4½'s* | *Pref. Stock* | *Com. Stk. No Par Val. $50 a Sh.* | *Cash Allocation* |
|---|---|---|---|---|---|
| Ft. Scott | $ 733 | $ 267 | $ ..... | $ ..... | $ 61.34 |
| Prior lien, Series A | 219 | 171 | 332 | 333.50 | 15.36 |
| Prior lien, Series B | 233 | 182 | 353 | 355.00 | 25.39 |
| Consols., Series A | 221 | 158 | 174 | 174.00 | 21.05 |
| Consols., Series B | 243 | 174 | 191 | 191.50 | 36.22 |

The Birmingham Bonds and priorities to the Reconstruction Finance Corporation and the Railroad Credit Corporation have been eliminated by the trustees' purchase of the total claims of those corporations, and the plan, in accordance with the order of this Court, provides for subrogation of those entitled to the income from which these claims were paid. Attached to the Commission's report, as Appendix "A" is a table showing the present capital structure of the Debtor corporation and the distribution of new securities under the plan now before this Court. A copy of the same is attached hereto in further amplifications of the provisions of said plan.

In addition to voluminous provisions relative to the terms of the new mortgages and stock issues and the mechanics of their execution and payment, the plan contains the following other provisions worthy of note. As to the consummation date, the plan states:

> "The plan shall be consummated by the issue and delivery of the new securities provided for in the plan as soon as practicable after confirmation of the plan and the reorganization managers shall publish, as directed by the court, notice of the date as of which the new securities are to be or shall have become available for delivery. The court on application of the reorganization man-

agers shall, in the light of the date or dates as of which the delivery of the properties to the reorganized company, the execution of the new mortgages and the issue and the delivery of the new securities have been, or are expected to be, accomplished, by order determine a convenient and appropriate date for giving effect to the plan (such date being herein called the consummation date)."

It further provides that the new reorganized company shall be incorporated under the laws of such State as the reorganization managers, with the approval of the Court, shall determine, and that all property of the Debtor, or any wholly owned subsidiary may in the discretion of the reorganization managers and the Court, be transferred to the new corporation. The plan further leaves unaffected the equipment obligations of the Debtor and of the bankruptcy trustees outstanding on the consummation date of the plan, and provides that the reorganized company shall pay all debts due from the debtor or the bankruptcy trustees for taxes due the United States, subject to statutes of limitations, and all expenses of reorganization, and shall assume all executory contracts of the Debtor (not disaffirmed) and of the trustees.

Relative to the claim of the holders of 100 shares of the Preferred Stock of the Kansas, Ft. Scott & Memphis Railway Company, discussed in the prior opinion of this Court, the Plan makes the following provisions:

"Since the holders of 100 shares of the preferred stock of the Kansas City, Fort Scott and Memphis Railway Company (hereinafter called the Fort Scott Company) not owned by the debtor have not procured a judgment of the court determining their rights, as required by the opinion of the court dated July 25, 1942, no provision can be made herein for such stockholders. If such stockholders shall be held to be not barred from assertion of their claims by the lapse of time and shall establish any claim against the debtor which the court shall determine to be secured by a lien or charge ahead of, or to be entitled to priority over, the prior-lien mortgage, the court may direct the reorganized company to issue to such stockholders such securities, or to pay to such stockholders such amount in cash, as in the opinion of the court will fairly represent their relative rights in respect of such claim."

Finally, the plan provides that if ordered by the Court after confirmation it may be executed by a sale or sales at not less than a fair upset price to be fixed by the Court of all or any parts of the property of the Debtor.

The first requirement of the statute, that the Court satisfy itself that the Plan complies with the provisions of sub-section (b), means simply that the plan must be that sort of a modification proposal contemplated by the Act, and that fixed charges are adequately covered by probable future earnings. A review of sub-section (b) by the Court reveals no aspects wherein this Plan in its entirety does not embrace such a modification as there contemplated and nothing to the contrary has been brought to the Court's attention.

As for fixed charges being covered by probable future earnings, although the Court considers this a matter particularly within the prov-

ince of the Commission, it should be noted that the amount of fixed charges provided in this Plan is approximately the same as that previously approved by the Court in its opinion of 1942. And no contention has been made that the Commission has in any way overburdened or over-capitalized the new Company in its Plan, although upon reconsideration the Commission has increased the permissible capitalization from $240,000,004.00 to $247,838,808.00. But this increase did not work to effect any substantial added burden in respect to fixed charges. The capitalization increase was granted at the suggestion of the bondholders and within this Court's authorization in its prior opinion stating that further consideration might be given to the matter of possibly increasing the total capitalization. The increase of $7,838,808.00 in capitalization authorized by the Commission was granted on rehearing on the basis of additional evidence of new sources of traffic that had been opened up since its prior hearing, exclusive of war installations, and the unusual amount expended for the upbuilding and maintenance of the Road during the time that it was in receivership and trusteeship, and the Court believes that the advised attitude of the Commission in allowing this slight increase is well founded.

That the Plan is fair and equitable in recognition of the rights of relative creditors, as found by the Commission, is, as previously stated, greatly reinforced by the acquiescence therein by the representatives of those creditors, and by the further fact that it is substantially the same plan as met in its greater detail the previous approval of this Court. The Court has, however, studied further the new arrangement of the Plan and has again satisfied itself that it is in all respects fair and equitable to all parties embraced within its provisions. The Court sees no necessity for further detailing the terms of the Plan and explaining their fairness when the Commission's report so adequately demonstrates this.

As for the second requirement of the Statute that the Court find that the amounts claimed for expenses and fees incident to the reorganization have been fully disclosed, are reasonable, are within maximum limits fixed by the Commission and subject to the approval of the Judge, the Court feels that, so far as they can now be ascertained, all expenses and fees have been disclosed by the petitions for allowances filed, pursuant to order of this Court of July 27th, 1944, which petitions have been referred to the Commission. It is the opinion of the Court that although these applications have not yet been acted on that the Court may proceed at this time with the approval of the Plan without awaiting the Commission's hearing if an order be entered providing that no payment of expenses or fees incident to the reorganization covered by petitions filed shall be made except as claimed, and within limits to be later fixed by the Commission, the amount to be approved as reasonable by subsequent court order. This provision will, therefore, be embodied in the order.

The third requirement of the Statute that the Plan must provide for the payment of all costs of administration, and all other allowances made or to be made by the Judge, is fully met by the most adequate provisions in the Plan itself and requires no further comment.

In its previous opinion in this case, this Court made itself very clear that it considered itself charged with the grave responsibility of seeing

to it that the new company would be one such as to hold the confidence of the community, and it suggested to the Commission that in this connection the new Plan should set up machinery with reference to reorganization managers, the naming of the first board of directors and, if necessary, provide for a voting trust. The Court is pleased to note that this suggestion has been adopted by the Commission in its new Plan and provision made for a voting trust to continue for five years from the consummation date of the Plan, said trust to include two voting trustees nominated by the committees whose bondholders will receive all of the stock and most of the second mortgage bonds, to be approved by the Court, and one voting trustee to be designated by the Court. Further, the Plan provides that the Court shall have power to disapprove persons designated by the reorganization managers as directors and, in the absence of an acceptable designation, to make its own designation. Finally, it is provided that the reorganization managers shall be designated, one by each of the bondholders' committees, subject to the approval of the Court, and one by the Court; and that if the Court should find at time of designation that any of the committees no longer holds or represents a substantial interest in the property, the Court may, in its discretion, designate said managers or trustees in lieu of such committee.

The Court now feels that these provisions adequately follow its admonitions and believes that with the power therein granted it the Court can carry out its previously expressed determination that the reorganized Company will begin its existence with a management composed of men of unquestioned standing, character, integrity and ability.

The Court will now consider the objections filed to the present plan of reorganization, addressing itself, first, to those filed by Lola Brooks, Administratrix, and John E. Dikis, Administrator. The claims of these parties are, so far as this reorganization is concerned, identical and will be considered together, although there are technically four separate claims. They arise out of judgments rendered in favor of the administrators for personal injuries to the four intestates as a result of the negligent operation of the Frisco Railroad. In all four cases, although the accident had occurred prior to receivership, consent judgments were entered in the State courts of Oklahoma by agreement with the Receivers, and claims were subsequently filed in this proceeding by the Administrators, allowed and approved as unsecured claims, and included in the report of the Receivers herein dated August 28, 1933. In essence, the position of these objectors is two-fold and in the alternative. First, they contend that if they are to be considered as unsecured creditors then the plan is inequitable, unjust and does not comply with the provisions of the Bankruptcy Act, and should be disapproved and returned to the Commission. The reasons assigned in support of this contention, however, do not differ from the Debtor's materially, and will stand or fall for the same reasons that will be subsequently considered.

The other string to the bow of these objectors is that these claims are entitled under the law and the facts to priority of payment over the claims of the mortgagees of the Debtor. The question of this

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NOTE: By order of March 27, 1945, the court amended the clause "at any time" in text of the opinion of March 16, 1945, to read as shown.

priority has, however, been referred by the Court to a Special Master for consideration and is still pending before him, and it has no bearing or relevancy on the question of the approval or disapproval of the Plan. If these creditors are subsequently held to be entitled to a priority, then the Plan itself provides that their claims will be paid in cash or assumed by the reorganized company. The Plan states:

> "Claims against the debtor entitled to priority over the respective mortgages and claims, current liabilities and obligations incurred by the bankruptcy trustees during the reorganization proceedings or by the receiver or receivers appointed by the court in the proceedings begun on November 1, 1932, to the extent unpaid at the date of consummation of the plan, shall be paid in cash or assumed by the reorganized company (subject to any applicable statutes of limitations). All such claims, liabilities and obligations may be paid and discharged by the reorganized company or may be adjusted or compromised and dealt with in such manner as may be determined by the board of directors of the reorganized company subject to the approval of the court. The interests of the holders of such claims, liabilities and obligations will not be adversely and materially affected by the plan."

Therefore, the objections of these parties need not work to hold up the approval of the Plan at this time and will, therefore, be overruled in their attack on the Plan, and held subject to subsequent decision so far as they relate to the question of priority

Finally, the Debtor on behalf of stockholders of the old company is again before this Court renewing its former objections and making new objections to the Plan. Some of these now before this Court were made to the Commission and overruled in its supplemental report and order of October 2, 1944, and others are assigned here for the first time. The objections are lengthy and repetitious, but quite naturally attack the basic point that the Plan excludes any equity in the Debtor. Essentially, the Debtor is merely continuing for the benefit of its stockholders the very gallant fight it has so long made for an, unfortunately, losing cause. The Court, however, today stands in the most fortunate position of having very clear guidance on all points in issue from the highest court in the land. In 1943, and since the prior opinion of this Court in 1942, the Supreme Court of the United States, in the cases of *Ecker* v. *Western Pacific Railroad Co.*, 318 U. S. 448 and *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company*, 318 U. S. 523, has conclusively given the answers to all of the objections that the Debtor now makes, and the Debtor's present position can only be sustained if this Court is to consider that those cases were wrongfully decided or that they do not hold what they so obviously appear to say.

The Debtor's contention is simply and basically that the exclusion of its equity is erroneous, for the reasons that the valuation, for reorganization purposes, of its system should have been determined at a substantially higher figure than the Commission set, and that the inception date of the Plan should have been set earlier so as to not recognize the whole of the accumulated bondholders' interest. The *Western Pacific* and *The Chicago, Milwaukee & St. Paul* cases, *supra*,

are, however, determinative of both of these issues. The Supreme Court has made it clear that the Commission's determination in regard to valuation and new capitalization is conclusive if supported by evidence and made in accordance with legal standards. The Supreme Court has also made it clear that although evidence of various elements of value is pertinent, prospective future earning capacity is the principal criterion under the Act, and that wartime earnings are not a reliable indication. Finally, the Supreme Court has stated very clearly in those cases that it is within the power of the Commission to set the effective date of the plan and that a recognition of accrued interest at its agreed rate is part of the fair and equitable nature of any plan. The language of those cases in support of the above propositions could not be clearer and this Court certainly does not propose to consider their wisdom.

That the finding of no value in the stock of the Debtor corporation and the findings as to permissible future capitalization are based on evidence, and made in accordance with legal standards, can hardly be doubted, and it would serve no purpose for this Court to set out all of the evidence which the Commission has heard, and all of the findings it has made, relevant to these questions. The Debtor has been at all times throughout this proceeding extremely vigilant in this regard, and the Court believes that the Commission has probably conducted as exhaustive a consideration of the questions of valuation and capitalization as is physically possible. Suffice it to say, that previous to February, 1944, there have been five hearings before the Commission and, in addition, this Court has held pre-trial conferences and had a previous hearing in 1941 at which essentially all present objections were considered. In connection with said hearing, valuation was considered by deposition and by hearing before a Special Master, and the Court included this matter in its previous opinion. The Commission has, to only partially paint the history of its investigation, gone exhaustively into the history of the Debtor corporation, including the development of its physical and financial structure and that of its subsidiaries; into the characteristics of its properties and their condition and improvements; into the traffic experience, year by year, by commodities and revenue tons carried, and by flow of traffic over various parts of the system, and by the prospect for the future; into operating revenues for each year since 1915 by classes and compared by ratios to the total in the preceding year; into expenses and operating ratios since 1915, both maintenance and improvement, and into taxation; into the net earnings available for interest since the Debtor has been in existence; and elaborately into the elements of physical value. The extent of the record on these questions is appalling, and it is difficult for the Court to understand how anyone could contend that the Commission has omitted to go into every phase of the Debtor's existence. The Court can find no exception with the record as it now stands sufficient for it to be able to say that the Commission has failed to consider any of the kinds of evidence deemed to be material under the Act by the Supreme Court, or to say that the Commission has not given proper weight and painstaking consideration to the various elements of value in its determinations. Rather, it is the present opinion of this Court that the Commission has properly concluded from the facts of record

the question of value. The Debtor seeks to have the permissible capitalization increased in order that it may participate in the new company, and yet it disregards that any increase sufficient to include the Debtor in any respect would have to be tremendous; and this for the reason that too many unsatisfied claims superior to stockholders' intervene. The allocation in the Plan to bondholders alone fails to equal the total of their claims, and it is estimated that there is at least about $126,000,000 aggregate of deficiencies that would have to be satisfied in full by allocations of new securities before any recognition could be given to stockholders, and this deficiency takes no recognition of the compensation for sacrifices in position that would have to be granted bondholders if the stock were recognized. It is, therefore, evident that prior calls on any new securities are far too large for the Debtor to be in the least benefited except by an increase in capitalization beyond all reason. The Supreme Court has said that it is primarily for the Commission to determine the questions of public interest, and the soundness of the Commission's determination of the permissible capital structure and contingent charges is to a great degree a question of public interest. Certainly there is nothing arbitrary in the Commission's determination here of the probable future earnings and the sound financial structure which those earnings will support.

As to the effective date, the Plan contains none, it is true, but for the purpose of computing claims for determining allocations in the Plan, the date January 1, 1944 was used. The provisions as to the consummation date of the Plan have been previously set out in this opinion, and the Court feels that the above use of "January 1, 1944" as the so-called effective date (the setting of said date having been held to be within the power of the Commission) adequately complies with the provisions of the law and is in no way arbitrary. An effective date in the Act refers only to the date used in computing allocations and does not mean the date when outstanding rights are modified. The latter date being the consummation date is elaborately provided for in the Plan itself and the Court feels that that is all that is required.

The Court, therefore, in spite of Counsel's able and conscientious advocacy of the stockholders, can find no substance in any of the objections of the Debtor, and believes that the contentions therein made are well settled by the above cited Supreme Court cases. Therefore, the objections of the Debtor should also be overruled in their entirety, and it will be so ordered.

The Court's attention has been called to the fact that there is a typographical error in the text of the Plan before this Court, in the 5th paragraph of said Plan, under the caption "Treatment of Existing Securities and Claims," wherein, in the first full paragraph on page 19 of the "Commission's Report on the Plan" the date "December 1, 1943" is set out. This date should be "December 31, 1943" and, since the Plan reserves the power in the Court to cure any defect therein, the Court will make this correction in its order of approval. In this connection the Plan states:

> "The construction of the plan by the court, whether before or after the submission of the plan to creditors, shall be final and conclusive. The court, whether before or after submission, may cure any defect, supply any omission, or reconcile any inconsistency,

in such manner or to such extent as may be necessary or expedient in order to carry out the plan effectively."

Having considered, therefore, all statutory requirements and overruled all objections to the Plan, it is the opinion of the Court that the plan should be approved *in toto*, and to that end counsel is directed to forthwith prepare and, after notice, submit for approval and signature a draft of a Decree approving the present Plan of Reorganization, consistent with this opinion and containing all necessary findings and conclusions.

Dated this 16th day of March, 1945.

(printed) GEO. H. MOORE
United States District Judge

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United States of America }
Eastern District of Missouri } ss.:

I, JAMES J. O'CONNOR, Clerk of the United States District Court in and for the Eastern District of Missouri, do hereby certify that the annexed and foregoing is a true and full copy of the original Memorandum Opinion of the Court approving the plan of reorganization for St. Louis-San Francisco Railway Co., debtor, as theretofore approved by the Interstate Commerce Commission, filed in the following styled case pending in this court under date of March 16th, 1945:

| | |
|---|---|
| "In the matter of<br>ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY,<br>*Debtor.* | In Proceedings for the Reorganization of a Railroad.<br>No. 7004." |

now remaining among the records of the said Court in my office.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the seal of the aforesaid Court at St. Louis, Missouri, this 24th day of March, A. D. 1945.

/s/ JAMES J. O'CONNOR
Clerk

By /s/ GEORGE J. BRENNAN
Deputy Clerk

(Seal)

(Appendix "A" is omitted here. It is the same as appendix "A" of the Commission's Report on Further Consideration printed on page 91 of pamphlet.)

IN THE

# DISTRICT COURT OF THE UNITED STATES

FOR THE EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION

| | |
|---|---|
| In the Matter of<br>ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, a Missouri corporation,<br>*Debtor.* | In Proceedings for the Reorganization of a Railroad.<br>No. 7004. |

## ORDER

APPROVING PLAN OF REORGANIZATION

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These proceedings duly coming on pursuant to the Order of Court dated October 11, 1944, for hearing on the Plan of Reorganization for the St. Louis-San Francisco Railway Company (hereinafter called the Debtor), approved by the Interstate Commerce Commission (hereinafter called the Commission) in its Report on Further Consideration and Amendatory Order dated July 4, 1944 (hereinafter called the Plan, which is by this reference made a part hereof) and its Second Supplemental Report and Order dated October 2, 1944, and certified to the Court by the Commission on October 8, 1944, together with the transcript of all the proceedings before the Commission and a copy of its said Report on Further Consideration and Amendatory Order Approving the Plan, and the Court having considered the entire record in these proceedings, including said transcript of all proceedings before the Commission and the evidence adduced and arguments presented at the hearing before this Court on November 16, 1944, and the Court having filed herein on March 16, 1945, an opinion approving the Plan;

The Court finds

1. There is a typographical or clerical error in the text of the Plan before this Court in the 5th paragraph of said Plan, under the caption "Treatment of Existing Securities and Claims," wherein, in the first full paragraph on page 19 of the "Commission's Report on the Plan" (Printed Record at page 7068) the date "December 1, 1943," is set out. This date should be "December 31, 1943" and will be regarded by the Court as corrected accordingly.

2. The findings and conclusions of the Commission stated in its Report of July 4, 1944 (Printed Record 6998) and its Second Supplemental Report dated October 2, 1944 (Printed Record 7083) are supported by evidence and in accord with legal standard and are correct in fact and law and are adopted as findings and conclusions of this Court, both as to liens of mortgages and otherwise without limitation, as fully as if set out at length herein.

3. The Plan:

(a) includes provisions modifying and altering the rights of creditors of the Debtor;

(b) provides for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded

debt, and rent for leased railroads) in such an amount that after due consideration of the probable prospective earnings of the property in the light of its earnings experience and all other relevant facts, there will be adequate coverage of such fixed charges by the probable earnings available for the payment thereof;

(c) provides adequate means for the execution of the Plan; and

(d) in all other respects complies with the provisions of subsection (b) of Section 77 of the Bankruptcy Act, as amended.

4. The Plan:

(a) is fair and equitable;

(b) affords due recognition to the rights of each class of creditors and stockholders;

(c) does not discriminate unfairly in favor of any class of creditors or stockholders;

(d) will conform to the requirements of the law of the land regarding the participation of the various classes of creditors or stockholders; and

(e) provides for the payment of all costs of administration and all other allowances made or to be made by this Court.

5. (a) By Order No. 242 entered December 30, 1940 (Printed Record 4739-4750), this Court required that each and every individual or corporation having or desiring to present any claim for expenses and fees incident to the reorganization herein should file such claim in the form of a petition in the office of the Clerk of this Court on or before February 15, 1941 and that a copy of each such petition should be forwarded by the Clerk of this Court to the Commission for the fixing of a maximum limit with respect to the amounts to be allowed for such expenses or fees. Petitions for such allowances were filed by numerous parties to this proceeding, such petitions generally covering the period prior to January 31, 1941. By its Report and Order dated August 27, 1941, the Commission fixed the respective amounts stated therein as the maximum limits of final allowances to be paid out of the estate of the Debtor, as reasonable compensation for all services rendered and as reimbursement for all actual and reasonable expenses incurred by such petitioners and their counsel and technical advisors in connection with the proceedings and plan of reorganization of the Debtor to January 31, 1941, without prejudice to further allowances of fees and expenses for periods subsequent thereto upon appropriate supplemental petitions. By Order No. 303, dated October 18, 1941 (Printed Record 5553-64) and later orders, this Court made reasonable allowances within the maximum limits fixed by such Report and Order and later action of the Commission.

(b) By Order No. 408 entered July 27, 1944 (Printed Record 6903-6911), this Court required that each and every individual and corporation having or desiring to present any claim for compensation for services rendered or for expenses (including reasonable attorneys fees) either under Clause (12) of Subsection (c) of Section 77, or otherwise, should file such claim in the form of a petition in the office of the Clerk of this Court on or before October 16, 1944, such petitions to cover all such services rendered and expenses incurred up to and including August 31, 1944; and said Order further provided that a copy of each such petition should be transmitted by the Clerk of this

Court to the Commission for the fixing of a maximum limit with respect to the amounts to be allowed for such compensation and expenses. Petitions for such allowances have been so filed by numerous parties to this proceeding, have been duly transmitted to the Commission and are now pending before the Commission. No payments of compensation or expenses prayed for by said petitions shall be made by the Debtor or by any corporation or corporations acquiring the assets of the Debtor, except in such amounts as may hereafter be approved as reasonable by order of this Court with such maximum limits as shall have been fixed by the Commission. No payment of expenses or fees incident to the reorganization for the period through August 31, 1944, shall be made by the Debtor, or any corporation or corporations acquiring the assets of the Debtor to any person except as prayed for in the petitions referred to in subparagraph (a) of this paragraph 4 or in this subparagraph (b) of this paragraph (4), subject, as to the amounts prayed for in the petitions referred to in this subparagraph (b), to the maximum limits to be fixed by the Commission and the actual amounts to be fixed by further order of this Court.

(c) Such additional amounts as may be required to be paid by the Debtor or any corporation or corporations acquiring the assets of the Debtor for services performed and expenses incurred (including reasonable attorneys fees) after August 31, 1944, in connection with the proceeding and the Plan, and in connection with the carrying out of the Plan, if it be finally confirmed, can not be ascertained at this time, but such amounts will be subject to the approval of this Court within maximum limits hereafter to be fixed by the Commission.

(d) The approximate amounts to be paid by the Debtor, or by any corporation or corporations acquiring the assets of the Debtor, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the time of said hearing before this Court on November 16, 1944, or at the date of this Order; so far as they can be so ascertained, said expenses and fees are reasonable; and said expenses and fees as to those heretofore allowed are, and as to those hereafter allowed will be, within maximum limits fixed by the Commission and within the maximum limits so fixed have been or are to be subject to the approval of this Court.

6. By Order No. 399-A entered April 20, 1944 (Printed Record 6761-4) this Court divided the creditors and stockholders of the Debtor into classes.

7. This Court has jurisdiction of the subject matter of these proceedings and of the Debtor and its properties, creditors and stockholders, and all other parties having claims against or interests in the Debtor or its properties.

8. The foregoing findings shall be taken and deemed to be findings of fact, and in addition, to the extent appropriate, conclusions of law and also orders.

WHEREFORE IT IS ORDERED:

First: All objections heretofore filed or urged herein to the Plan, and all claims heretofore filed or urged herein for equitable treatment otherwise than through the Plan, are hereby severally overruled and denied and the motions to remand the Plan to the Commission and to dismiss the proceedings are hereby severally overruled and denied.

Second: The Plan is hereby in all respects approved.

Third: The findings made by the Commission that the claims referred to in the Plan under the heading "Claims not affected by the Plan" (Printed Record 7069-72) will not be adversely and materially affected by the Plan are hereby affirmed. The Plan provides for the payment of all claims of the United States for taxes, and the United States is not a creditor on any claims for customs duties.

Fourth: The findings of the Commission (Printed Record 7068-69) that the interests or equities of (1) general creditors of the Debtor, (2) holders of preferred stock of the Debtor; (3) holders of common stock of the Debtor and (4) holders of claims against the Debtor entitled to priority or preference over the claims of general creditors, but not over any one or more of the mortgages, have no value and nothing shall be distributable to them are hereby affirmed.

Fifth: The Plan, corrected as hereinbefore set forth in paragraph (1) hereof, shall be submitted as promptly as possible in accordance with the provisions of said Section 77 to the holders of claims designated in classes, 2, 3, 4 and 5 of this Court's said Order of April 20, 1944 (Printed Record 6761).

Sixth: The Court reserves full jurisdiction to construe the Plan, to cure any defect, supply any omission, and reconcile any inconsistency and to exercise all its powers under the Plan, all in such manner and to such extent as may be necessary or expedient in order to carry out the Plan effectively.

(Printed) GEO. H. MOORE
U. S. District Judge

Dated April 10th, 1945.
Filed Apr. 10, 1945.

JAS. J. O'CONNOR
Clerk

---

United States of America }
Eastern District of Missouri } ss.:

I, JAMES J. O'CONNOR, Clerk of the United States District Court in and for the Eastern District of Missouri, do hereby certify that the annexed and foregoing is a true and full copy of the original ORDER (No. 447-A) APPROVING PLAN OF REORGANIZATION, filed April 10th, 1945 In the Matter of ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, a Missouri Corporation, Debtor, In Proceedings for the Reorganization of a Railroad, No. 7004, and now remaining among the records of the said Court in my office.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the seal of the aforesaid Court at St. Louis, Missouri, this 12th day of April, A. D. 1945.

(typed) JAMES J. O'CONNOR
Clerk

By /s/ SAYMOND E. WALZYK
Deputy Clerk

(Seal)

Nos. 1108-10

FILED
MAY 4 1946
CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

*October Term, 1945*

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, ET AL.

*vs.*

FORT SCOTT BONDHOLDERS' COMMITTEE, ET AL.

## Brief for Respondents in Opposition to Petition for Writs of Certiorari

DAVIS POLK WARDWELL SUNDERLAND & KIENDL
15 Broad Street
New York 5, N. Y.
EDWIN S. S. SUNDERLAND
THOMAS O'G. FITZGIBBON
JAMES L. HOMIRE
*Attorneys for Fort Scott Bondholders' Committee*

HUNTON, WILLIAMS, ANDERSON, GAY & MOORE
1003 Electric Building
Richmond 12, Virginia.
HENRY W. ANDERSON
GEORGE D. GIBSON
JOHN W. RIELY
*Attorneys for Prior Lien Bondholders' Committee*

CRAVATH, SWAINE & MOORE
15 Broad Street
New York 5, N. Y.
ROBERT T. SWAINE
LEONARD D. ADKINS
*Attorneys for Consolidated Bondholders' Committee*

WHITE & CASE
14 Wall Street
New York 5, N. Y.
FITZHUGH MCGREW
JESSE E. WAID
*Attorneys for Bankers Trust Company, Trustee, The Kansas City, Fort Scott and Memphis R. Co. Refunding Mortgage.*

RATHBONE, PERRY, KELLEY & DRYE
70 Broadway
New York 4, N. Y.
ALEXANDER M. LEWIS
*Attorneys for Central Hanover Bank and Trust Company, Trustee, St. Louis-San Francisco R. Co. Prior Lien Mortgage.*

MILBANK, TWEED, HOPE, HADLEY & MCCLOY
15 Broad Street
New York 5, N. Y.
ORVILLE W. WOOD
*Attorneys for The Chase National Bank of the City of New York and John A. Aid, Trustees, St. Louis-San Francisco R. Co. Consolidated Mortgage.*

Dated May 3, 1946

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### Statute Cited


Judicial Code § 240(a), 28 U. S. C., § 347 ..... 1


### Other Authority


52nd Annual Report, Interstate Commerce Commission (1938) 4 1


## RECORD REFERENCES

A.—The Appendix to the Petition

Ex.—Exhibits introduced before the Commission

Pro.—The printed proceedings in the District Court

R.—The printed transcript of record

# Brief for Respondents in Opposition to Petition for Writs of Certiorari

## OPINION OF COURT BELOW

The opinion of the court below (the Circuit Court of Appeals for the Eighth Circuit), printed at R. 184, is reported at 153 F. 2d 312.

## JURISDICTION

The date of the orders sought to be reviewed is February 8, 1946.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C., Sec. 347).

## STATEMENT

This case involves a plan for the reorganization of a railroad under Section 77 of the Bankruptcy Act.

The road has been in reorganization every 20 years. Originating in a reorganization in 1876, it went through reorganization again in 1896 and 1916 and returned for further reorganization, slightly ahead of schedule time, in 1932. As the Commission said in 1938, the Debtor has

> "always suffered, among other things, from overcapitalization in the worst sense of the word."[1]

After repeated hearings on a plan under Section 77, and on a full record, the Commission found in July, 1940, that "the total capitalization after reorganization should be

[1] 52nd Annual Report of the Interstate Commerce Commission to the Congress, dated November 1, 1938, p. 4.

about $240,000,000" (A. 44). The plan so approved was disapproved by the District Court on the ground of preferential treatment of certain claims that were later purchased by the estate in a compromise settlement (A. 73-74). On remand to the Commission a further hearing was held in February, 1944. In the light of the court's opinion that the Commission was free to increase the total new capitalization (Pro. 6015, 6017), evidence was introduced as to war earnings through 1943, new traffic sources, improvements to the property, and future prospects. On this modernized record the Commission found, in July, 1944, that some increase was permissible and that a total new capitalization of 248 million dollars should be approved (A. 82).

But this was far less than the claims of bondholders. The deficiency exceeded 110 million dollars, as shown in the following table:

| | *Old Capitalization of Debtor (in 000's)* | *New Capitalization under Plan (in 000's)* |
|---|---|---|
| Fixed interest lien debt | $359,444[2] | $ 76,371 |
| Contingent interest lien debt | ——— | 47,550 |
| Total debt | 366,029[3] | 123,921 |
| Preferred Stock | 49,158 | 61,860 |
| Common Stock | 65,543 | 62,058 |
| | $480,731 | $247,839 |

So the Commission found that the claims of general creditors and the interests of holders of the old stock were without value and they should receive nothing under the Plan (A. 82). The Plan was then certified to the District Court.

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[2]This figure as stated in Plan, less the cash required to be paid out by the Plan. The other figures as stated in Plan (A. 91). The old capitalization is stated as of January 1, 1944; it is greater as of any later date, because cash distributions were less than interest accruals.

[3]There was no unsecured debt except a minor amount of claims of general creditors, including the petitioners in Nos. 1108-9, some of which may have been secured by junior liens.

The Debtor objected there that (*i*) new capitalization should be larger and (*ii*) interest should not be recognized on the bonds at contract rates. These objections, concurred in by Brooks and Dikis, were overruled and the District Court approved the Plan (A. 97).

The Debtor, joined by Brooks and Dikis, appealed to the Circuit Court, again urging the same two questions as the mainstay of their case. They were overruled by the Circuit Court (R. 184) and the order of the District Court approving the Plan was affirmed (R. 195).

It is to review this action of the Circuit Court that certiorari is sought.

## QUESTIONS PRESENTED

The basic questions presented here, as in the courts below, are:

1. Was the Circuit Court right in holding that there was warrant for the District Court to find that the Commission acted within its powers in fixing the total amount of the new capitalization?

2. Were the tribunals below right in holding that, in determining the new securities issuable in respect of mortgaged property, the bondholders are entitled to recognition not only for their principal, but also for their unpaid interest accrued at contract rates?

Minor questions presented here, and also below, are:

3. Were the tribunals below right in holding that there are in this case no unmortgaged assets?

4. Was the Circuit Court right in disposing of these appeals from the order approving the Plan despite the pendency of a later appeal from an order confirming the Plan, where the later appeal raises no substantial issue?

In addition the Petition seeks to present here numerous arguments against the reorganization pattern of Section 77. Many were not presented to any tribunal below and none is pertinent to any ruling or issue below unless in some such way as this:

5. Was the Circuit Court right in refusing to reject the statutory scheme of Section 77 because of arguments that if the Congress had said something different, resourceful management might conceivably have been able to achieve some different result, or because of the possibility that the Congress may still say something different?

## ARGUMENT

### 1.

### The Amount of the Total New Capitalization in this Case is a Matter of no General Interest

There is nothing novel in the standard applied by the Commission here. It is the familiar standard, long applied in equity practice and lately established by this Court as the intention of Section 77,[4] by which all circumstances are considered, including even the elements of physical value, but primary weight is given to prospective earning capacity, in order, as the Commission said here, that the new securities may be such as

> "would give the holders thereof some prospect of interest or dividends, and would otherwise be compatible with the public interest" (A. 45).

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[4] *Ecker* v. *Western Pacific R.*, 318 U. S. 448, 483 (1943) [cited as *Western Pacific Case*]; *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R.*, 318 U. S. 523, 539-41 (1943) [cited as *Milwaukee Case*].

It was manifest to the Circuit Court that this was merely another application of the principles declared in the *Western Pacific Case* and the *Milwaukee Case*. Nothing need be added to the Circuit Court's discussion on that point (R. 187-92).

This is not the place to review the sufficiency of the evidence to make a basis for Commission power to reach the particular result it did in this particular case. That would put no question of general interest. If a question of general interest could conceivably arise on such a point in any case, it does not here. Reported earnings in the period 1921-1943, after Federal income taxes at 35%, failed by 27 million dollars to cover the indicated return on the new senior securities and dividends at 6% on the new Common Stock, without any provision for improvements to the property. Since 1943, the last full year before the Commission when it acted, net earnings have declined as cost levels have notoriously mounted. The entire net current assets[5] are less than half the bondholders' unrecognized claim. It is, in short, a typical case for finality of administrative judgment.

## 2.

## The Bondholders' Right to Interest is Settled Law

Each of the mortgages is in terms security for interest as well as principal,[6] and together they cover the whole system (R. 193). In such circumstances it is settled law that no junior interest can participate until the bondholders receive full satisfaction, not only for their principal, but also for their unpaid interest accrued at contract rates. This rule is

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[5]41 million dollars at September 30, 1945 (R. 179).

[6]Ex. 13, p. 45; Ex. 14, p. 102; Ex. 15, p. 165 (all in the original, unprinted transcript).

settled in equity,[7] in bankruptcy,[8] under Section 77B[9] and under Section 77.[10] It is admitted in the Petition with respect to satisfaction of bondholders' claims out of their security (p. 27), and as said above, the liens cover everything here. The distributions made during the proceeding are applicable to accrued interest, and not to principal, by the express terms of the mortgages.[11] Prior rights are enforced against general creditors as well as stockholders.[12] There is no question on these matters to review.

### 3.

### There are no Unmortgaged Assets

The only asset that the Petition claims to be unmortgaged is the 1.3 million dollars of cash that was on hand when receivers were appointed on November 1, 1932 (Petition, pp. 5, 20), a sum, it is asserted, which "The Trustee of the District Court has in hand" (*id.* p. 5). But the record shows that current claims of more than twice that amount, including 1.6 million dollars of pay-roll alone, were accrued and unpaid on November 1, 1932, and were in fact paid during that month (Pro. 188-9). It is to be presumed that cash on hand at the inception of receivership was applied to current

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[7]*American Iron and Steel Mfg. Co.* v. *Seaboard Air Line R.*, 223 U. S. 261, 266-7 (1914); *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, 412, 413 (1938).

[8]*Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 597, n. 30 (1935); *Ticonic National Bank* v. *Sprague*, above.

[9]*Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 527 (1941).

[10]*Western Pacific Case*, 318 U. S. at 509-10; *Milwaukee Case*, 318 U. S. at 546.

[11]Ex. 13, pp. 38-39; Ex. 14, p. 95; Ex. 15, p. 157 (all in the original, unprinted transcript). The cited provisions deal with possession by the indenture trustee, but the debtor trustee holds for him.

[12]*Western Pacific Case*, 318 U. S. at 483; *Milwaukee Case*, 318 U. S. at 569.

claims then accrued and payable. Clearly such cash is the fund primarily chargeable with the payment of such claims.[13]

## 4.

## The Circuit Court was not Barred from Deciding the Case by Petitioners' Later Unfounded Appeal

On submission of the Plan for a vote of creditors pursuant to Section 77(e), it was accepted by all voting classes (R. 195 and Pro. 7887). Section 77(e) requires that:

> ". . . the judge shall confirm the plan if satisfied that it has been accepted by . . . [the statutory vote] and that such acceptances have not been made or procured by any means forbidden by law . . ."

If the plan has not been so accepted, the judge may nevertheless confirm it if, upon a review of the merits of the plan, he again finds that it is fair and equitable and otherwise in conformity with the statutory requirements (subdivision (e) of Section 77). But as the quoted words show, and as this summary of the adjoining proviso emphasizes, the judge has no concern with the merits of a plan accepted by all voting classes. He is required to confirm it if the procedure of voting was lawful.

This was pointed out to the Circuit Court and is so held in its opinion (R. 195). It is not questioned by Petitioners, either below or here.

Yet the Petition makes no suggestion of illegality in the procedure of voting, though that is the only statutory issue. It is rightly silent in this respect, for we vouch the record to show that no such suggestion was made at the hearing on confirmation of the Plan.[14] It seems clear, therefore, that

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[13] *Guaranty Trust Co.* v. *Albia Coal Co.*, 36 F. 2d 34 (C.C.A. 8, 1929).

[14] This hearing was after the preparation of the record in the appeals below, and is not of record here.

no issue can be presented by Petitioners' appeals from the confirmation order. The entire merits, in short, arise in these appeals from the approval order, and the appeals from the confirmation order are a mere technicality.

The fact that the Circuit Court is deferring action on Respondents' motion to dismiss the appeals from the confirmation order until the Petition is disposed of is entirely irrelevant to the merits of the Petition. The Circuit Court itself found no reason to defer action on the approval order until disposition of the insubstantial appeals from the confirmation order. On the contrary, as it rightly said (R. 195):

> "If the plan has been accepted and the acceptance has been properly obtained, it will then be confirmed. In the instant case, the plan has already been accepted by more than two-thirds of those voting in each class to which submission was required. Certainly, in those circumstances there should be no further delay in this proceeding which has already been pending for more than twelve years."

This was altogether unlike the situation presented to the Circuit Court in *In re Denver and Rio Grande Western R.*, 150 F. 2d 28 (C.C.A. 10, 1945), *cert. granted*, 90 L. Ed. *32 (1945, cited in Petition p. 18). There one of the voting classes had rejected the plan, so its merits were again to be reviewed on the issue of confirmation. Accordingly that court, having to consider the merits on two sets of appeals, decided them together, as a matter of its own convenience, without professing to lay down any rule of general application.

## 5.
## Petitioners' Other Arguments Lie Merely in the Realm of Debate

The obscure invocation of "extraordinary powers" in the Petition (p. 22) apparently looks to some financial experimentation, by which the court, instead of approving or disapproving a Commission plan, as Section 77 directs, would seek to whittle down the claims of creditors, by purchases of bonds at a heavy discount during a default in interest, etc., for the purpose of re-establishing a vanished equity. But these are not complaints against a disapproval below of any particular proposal. In fact none was made. They are merely arguments that conceivably the Congress might have provided some reorganization pattern other than what it did.

Changes in Section 77 are currently being discussed in the Congress (Petition, p. 22 and Appendix B). But such discussion is not a way of trying the issues in any particular case, for there is no full hearing or opportunity to reply in the judicial sense. For that matter, the Congress does not purport to exercise the judicial function, indeed could not constitutionally do so. That such discussion may eventuate in some change in the law is mere speculation. Until the Congress enacts new legislation, Section 77 remains the governing statute.

It is equally a mere matter of debate whether the Debtor is entitled to represent unsecured creditors not directly represented by their own counsel. We see nothing in the Circuit Court's opinion or decision that denies the asserted right, and we think it an academic question here, which this Court has no reason to decide, whether the Debtor may or may not speak for people who are not entitled to receive anything.

## CONCLUSION

The Petition should be denied.

Dated May 3, 1946.

Respectfully submitted,

DAVIS POLK WARDWELL SUNDERLAND & KIENDL
15 Broad Street,
New York 5, N. Y.,
*Attorneys for Fort Scott Committee*

EDWIN S. S. SUNDERLAND,
THOMAS O'G. FITZGIBBON,
JAMES L. HOMIRE,
*Of Counsel*

HUNTON, WILLIAMS, ANDERSON, GAY & MOORE
Electric Building,
Richmond 12, Virginia,
*Attorneys for Prior Lien Committee*

HENRY W. ANDERSON,
GEORGE D. GIBSON,
JOHN W. RIELY,
*Of Counsel*

CRAVATH, SWAINE & MOORE
15 Broad Street,
New York 5, N. Y.
*Attorneys for Consolidated Committee*

ROBERT T. SWAINE,
LEONARD D. ADKINS,
*Of Counsel*

WHITE & CASE
14 Wall Street,
New York 5, N. Y.
*Attorneys for Bankers Trust Company, Trustee, The Kansas City, Fort Scott and Memphis R. Co. Refunding Mortgage.*

FITZHUGH MCGREW,
JESSE E. WAID,
*Of Counsel*

RATHBONE, PERRY, KELLEY, & DRYE
70 Broadway,
New York 4, N. Y.
*Attorneys for Central Hanover Bank and Trust Company, Trustee, St. Louis-San Francisco R. Co. Prior Lien Mortgage.*

ALEXANDER M. LEWIS,
*Of Counsel*

MILBANK, TWEED, HOPE, HADLEY & McCLOY
15 Broad Street,
New York 5, N. Y.
*Attorneys for The Chase National Bank of the City of New York and John A. Aid, Trustees, St. Louis-San Francisco R. Co. Consolidated Mortgage.*

ORVILLE W. WOOD,
*Of Counsel.*